S. HRG. 99-994

LINER DEVELOPMENT ACT OF 1986

HEARING

BEFORE THE

SUBCOMMITTEE ON MERCHANT MARINE

OF THE

COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION UNITED STATES SENATE

NINETY-NINTH CONGRESS

SECOND SESSION

ON

S. 2662

TO DIRECT THE SECRETARY OF TRANSPORTATION TO ENTER INTO CERTAIN CONTRACTS AND CONTRACT AMENDMENTS TO DEVELOP AND DEREGULATE THE UNITED STATES-FLAG LINER FLEET

JULY 24, 1986

Printed for use of the
Committee on Commerce, Science, and Transportation

U.S. GOVERNMENT PRINTING OFFICE

65-003 O WASHINGTON : 1987

For sale by the Superintendent of Documents, Congressional Sales Office
U.S. Government Printing Office, Washington, DC 20402

S261-15

COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION

JOHN C. DANFORTH, Missouri, *Chairman*

BOB PACKWOOD, Oregon
BARRY GOLDWATER, Arizona
NANCY LANDON KASSEBAUM, Kansas
LARRY PRESSLER, South Dakota
SLADE GORTON, Washington
TED STEVENS, Alaska
BOB KASTEN, Wisconsin
PAUL S. TRIBLE, JR., Virginia

ERNEST F. HOLLINGS, South Carolina
RUSSELL B. LONG, Louisiana
DANIEL K. INOUYE, Hawaii
WENDELL H. FORD, Kentucky
DONALD W. RIEGLE, JR., Michigan
J. JAMES EXON, Nebraska
ALBERT GORE, JR., Tennessee
JOHN D. ROCKEFELLER IV, West Virginia

W. ALLEN MOORE, *Chief Counsel and Staff Director*
RALPH B. EVERETT, *Minority Chief Counsel and Staff Director*

SUBCOMMITTEE ON MERCHANT MARINE

TED STEVENS, Alaska, *Chairman*

SLADE GORTON, Washington
BOB KASTEN, Wisconsin
PAUL S. TRIBLE, JR., Virginia

DANIEL K. INOUYE, Hawaii
RUSSELL B. LONG, Louisiana
JOHN D. ROCKEFELLER IV, West Virginia

CONTENTS

	Page
Opening statement by Senator Stevens	1
Opening statement by Senator Inouye	1
Text of S. 2662	3

LIST OF WITNESSES

Abely, Joseph F., Jr., chairman and chief executive officer, Sea-Land Service, Inc.; William B. Bru, chairman and chief executive officer, United States Lines, Inc.; and Frank Drozak, president, Seafarers International Union of North America, AFL-CIO	66
Prepared statements:	
Mr. Abely	67
Questions of Senator Inouye and the answers	74
Mr. Bru	80
Questions of Senator Inouye and the answers	82
Anderson, David F., associate general counsel, Matson Navigation Co., Inc	110
Prepared statement	111
Butchman, Alan A., on behalf of Totem Ocean Trailer Express, Inc	113
Prepared statement	114
Gaughan, Hon. John A., Administrator, Maritime Administration, DOT; accompanied by Richard Bowman, Associate Administrator for Maritime Aids; Michael McMorrow, Acting Chief Counsel; and Edward Fitzgerald, Director, Office of Trade Studies and Subsidy Contracts	29
Questions of Senator Inouye and the answers	34
Hearn, George H., senior vice president, Waterman Steamship Corp.; accompanied by John Meade, attorney; and Edward L. Merrigan, counsel, Central Gulf Lines, Inc	94
Prepared statements:	
Mr. Hearn	96
Mr. Merrigan	103
Mills, Thomas L., on behalf of Crowley Maritime Corp	107
Prepared statement	108
Tavrow, R. L., senior vice president and general counsel, American President Lines, Ltd.; George F. Lowman, chairman and chief executive officer, Farrell Lines; and W. James Amos, Jr., chairman and chief executive officer, Lykes Brothers Steamship Co	40
Prepared statements:	
Mr. Tavrow	42
Mr. Amoss	50
Questions of Senator Inouye and the answers	62

ADDITIONAL ARTICLES, LETTERS, AND STATEMENTS

Corrado, Ernest J., vice president, American Institute of Merchant Shipping, letter	122
DeFries, C. E., president, National Marine Engineers Beneficial Assn., statement	119

LINER DEVELOPMENT ACT OF 1986

THURSDAY, JULY 24, 1986

U.S. SENATE,
COMMITTEE ON COMMERCE, SCIENCE AND TRANSPORTATION,
SUBCOMMITTEE ON MERCHANT MARINE,
Washington, D.C.

The subcommittee met, pursuant to notice, at 10:00 a.m. in Room SR-253, Russell Senate Office Building, Hon. Ted Stevens [chairman of the subcommittee] presiding.

Staff members assigned to this hearing: Brad Gilman and Bob Eisenbud, professional staff members; and John Hardy, minority staff counsel.

OPENING STATEMENT BY SENATOR STEVENS

Senator STEVENS. Good morning. We have scheduled this hearing to review S. 2662, a proposal to reform the operating and differential subsidy program administered by the Maritime Administration. The hearing will also focus on two related administrative actions, the proposed consolidation of essential trade routes and the revocation of General Order 80.

Senator Inouye and I introduced S. 2662 by request so the bill would become a part of this hearing. This bill is designed to eliminate the distinction between subsidized and non-subsidized operators currently operating in foreign commerce. If this effort could be successful, the U.S. liner companies would then begin to gain ground, we feel, in the market share held by foreign flag operators, instead of competing solely with themselves for preference cargoes.

Let me call on my good friend from Hawaii, Senator Inouye.

OPENING STATEMENT BY SENATOR INOUYE

Senator INOUYE. Well, I wish to congratulate my distinguished chairman. Thanks in large measure to the process he initiated over a year ago, it appears that there is a realistic chance to achieve a consensus within the maritime industry on legislation to reform the liner ODS program.

To be sure, there are still several obstacles to be overcome and legitimate objections to be met. But it seems to me that we finally have a specific legislative framework within which these remaining problems can be resolved to the satisfaction of everyone.

If we are to achieve our ultimate goal, however, it is more important than ever that a magnanimous spirit of give and take prevail among the negotiating parties. There are very few legislative days left in the session, and it would be impossible to move legislation of this magnitude unless everyone marches in lockstep.

There is not enough time on the Senate legislative agenda to consider any more controversial matters. It is therefore the eleventh hour at the bargaining table, and the time for trying to negotiate an edge is over. The welfare of all is at stake, and we will only achieve the necessary consensus if each of the parties limits his requirements to the essentials.

I thank you very much, Senator.

Senator STEVENS. Thank you.

We are delighted to see our chairman here. Mr. Chairman, do you have any comments?

The CHAIRMAN. Mr. Chairman, I do not. I am glad to be here to learn more about what is obviously a very serious problem and to see what can be done to solve it.

Senator STEVENS. Thank you very much.

[The bill follows:]

99TH CONGRESS
2D SESSION

S. 2662

To direct the Secretary of Transportation to enter into certain contracts and contract amendments to develop and deregulate the United States-flag liner fleet.

IN THE SENATE OF THE UNITED STATES

JULY 21, 1986

Mr. STEVENS (for himself and Mr. INOUYE) (by request) introduced the following bill; which was read twice and referred to the Committee on Commerce, Science and Transportation

---

A BILL

To direct the Secretary of Transportation to enter into certain contracts and contract amendments to develop and deregulate the United States-flag liner fleet.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act may be cited as the "Liner Development Act of 1986".

DECLARATION OF PURPOSES

SEC. 2. The purposes of this Act are to—

(a) develop and maintain an efficient, competitive United States-flag liner fleet, capable of carrying a

substantial portion of the foreign commerce of the United States and competing in international trade;

(b) eliminate unnecessary regulations and restrictions on the United States-flag liner fleet thereby enhancing its ability to compete and enabling it to operate as productively and safely as operating and engineering technology allow;

(c) establish a policy whereby an operating-differential subsidy is available to all qualified liner operators on equal terms and conditions, and whereby all such liner operators are provided an equal opportunity to participate therein during the same time period;

(d) assure the availability in time of war or national emergency of an existing, operating United States-flag liner fleet serving as a naval or military auxiliary and able to maintain the flow of essential commerce at all times; and

(e) maintain a skilled pool of United States-citizen seamen manning that liner fleet while recognizing that the costs of United States citizen crews are necessarily higher than those of foreign crews manning the vessels with which the United States-flag liner fleet must compete.

SEC. 3. Title VI of the Merchant Marine Act, 1936, as amended, is amended by adding the following sections:

"SEC. 616. LINER OPERATING-DIFFERENTIAL SUBSIDY CONTRACTS AND CONTRACT AMENDMENTS.

"(a) The Secretary is authorized and directed to enter into an operating-differential subsidy contract or contracts with any citizen of the United States entitled under section 617 to enter into such contract or contracts for the operation of qualified vessels in international trade and the payment of operating-differential subsidy determined in accordance with subsection (c) as provided in sections 617, and 619 through 625, as applicable.

"(b) The Secretary is authorized and directed, upon notification by the operator pursuant to sections 618 and 622(a), to amend operating-differential subsidy contracts existing on the date of enactment as provided in section 618.

"(c) All operating-differential subsidy contracts referred to in this section, including contract amendments, shall for all purposes constitute prior legal obligations incurred by the United States. No such contract, nor the authority of the Secretary to enter into such contract, nor the entitlement of a citizen of the United States to enter into such contract, shall be conditioned in any manner on receiving budget authority for such contract in advance in an appropriations act, or otherwise so limited, or conditioned in any manner on the extent to which amounts to liquidate the obligations incurred under such contracts are provided in an appropriations act, or otherwise so limited. No contract amendment under this Act

shall affect the status of an operating-differential subsidy contract in effect at the time of enactment as a binding legal and contractual obligation of the United States or relieve the United States of any obligation to make payment under such contract except as provided in section 618(f), and contracts entered into after January 1, 1986, shall have the same force and effect as binding legal and contractual obligations of the United States as contracts entered into before January 1, 1986. Subject to the provisions of section 623, contractors shall be entitled to receive operating-differential subsidy payments for the operation of contract liner vessels in international trade engaged in the carriage of cargo in the foreign commerce of the United States, or in services authorized to receive operating-differential subsidy under section 605(a). Such payments shall be equal to the wage differential, as defined in section 625(6), which results from the operation of contract vessels, plus the payments provided in section 618(f). Contractors shall be entitled to receive such payments for the number of ship years of operation, but in no case more than provided for in section 623.

"(d) At such time as a contract or contract amendment as provided for in subsections (a) and (b) becomes effective with respect to a contractor, such contractor shall be subject to the provisions of sections 616 through 625, as applicable, which shall be substantive law applicable to such contract or

contract amendment. Voyages of the contractors' contract vessels in progress at the time such contract or contract amendment becomes effective shall receive operating-differential subsidy as provided for in sections 617 through 625 for those portions of the voyages in progress which occurred after midnight (eastern standard time) of the date such contract or contract amendment becomes effective.

"SEC. 617. PERSONS ENTITLED TO ENTER INTO OPERATING-DIFFERENTIAL SUBSIDY CONTRACTS.

"A citizen of the United States shall be entitled to enter into a contract for the payment of operating-differential subsidy equal to the wage differential, as defined in section 625(6), determined in accordance with section 616(c), if it:

"(a) has operated liner vessel or vessels documented under the laws of the United States in international trade for the continuous one year period immediately prior to the date of enactment, or

"(b) more than thirty days subsequent to the date of enactment, submits to the Secretary an application consistent with the purposes and policies set forth in section 2 of this Act, and is found by the Secretary to possess the ability, experience, financial resources, and other qualifications necessary to operate and maintain a qualified vessel or vessels, and to have operated a liner vessel or vessels in foreign commerce documented

under the laws of the United States for the continuous one year period immediately prior to application, and proposes operation of qualified vessels which the Secretary determines will further the purposes and policies set forth in section 2 of this Act.

"SEC. 618. AMENDMENT OF OPERATING-DIFFERENTIAL SUBSIDY CONTRACTS.

"(a) A citizen of the United States which is a party to an operating-differential subsidy contract or contracts for the operation of liner vessels under this title on the date of enactment hereof shall be entitled to amend such contract or contracts as provided in this section.

"(b) Notwithstanding any other provision of law, the contract amendment provided for in this section shall not affect the terms and conditions of the existing contract except as specifically provided by this section. The amendment shall provide with respect to costs incurred more than twenty-four months after the date of enactment hereof that the amount of operating-differential subsidy payable under such contract for the operation of United States-flag vessels shall equal the wage differential as defined in section 625(6). Sections 601(a) and 602 shall not apply to such contract amendment or govern in any way the payment of operating-differential subsidy under such amended contract. Upon the Secretary's receipt of notification from an operator that it has elected to

amend its contract in accordance with the terms of section 622, the following contractual provisions and provisions of law shall not apply to such contract:

"(1) any provision, including but not limited to provisions contained in sections 211, 601(a), 603(b), 605(c), 606(3), 606(4), 606(5), 801, and 809(a), which in any manner governs, affects, regulates, restricts, or requires the operation of subsidized vessels on particular routes, lines, or services or on a particular schedule, except as provided in subsections 603(a)(2), (a)(3), and (a)(4); or in any manner precludes or otherwise regulates any nonsubsidized operations except as provided in section 620; or in any manner precludes the operation of vessels or the payment of subsidy based on a restriction of operations to particular routes, lines, or services, or based on a minimum or maximum number of sailings; or in any manner prevents the interchange or transfer of vessels;

"(2) any provision of title VIII of the Merchant Marine Act, 1936, except as expressly made applicable to contracts for the payment of operating-differential subsidy entered into under sections 616(a) and 617(a); and

"(3) the provision, including sections 601(a) and 610(1), that a vessel or vessels operated under the contract be built in the United States.

"(c) The contract amendment shall incorporate the provisions of section 620.

"(d) Any provision in an operating-differential subsidy contract amended under this section which imposes a requirement not imposed or expressly excepted by subsections (a), (b), and (c) or is otherwise inconsistent with subsections shall be deemed void as of the date the Secretary is notified pursuant to section 622 that the operator has elected to enter into such amendment.

"(e) Any regulation, ruling, or other agency action which imposes a requirement not imposed or expressly excepted by subsections (a), (b), and (c) or is otherwise inconsistent with subsections (a), (b), and (c), shall not be applicable to any operating-differential subsidy contract amended under this section as of the date the Secretary is notified pursuant to section 622 that the operator has elected to enter into such amendment.

"(f) With respect to contracts which have been amended as provided in this section the United States shall not, with respect to costs incurred more than twenty-four months after the date of enactment, be liable for payments other than wage differential payments. Prior to such date, payments at-

tributable to costs other than excess subsidizable wage costs shall be payable, but only for the period provided for in the operator's contract at the date of enactment.

"SEC. 619. LINER VESSELS ENTITLED TO BE OPERATED UNDER OPERATING-DIFFERENTIAL SUBSIDY CONTRACTS AND CONTRACT AMENDMENTS.

"A liner vessel operated or to be operated by or for a citizen of the United States entitled under section 617(a) to enter into an operating-differential subsidy contract or entitled under section 618(a) to enter into a contract amendment, shall be entitled to be operated under such contract or amended contract, on or after thirty days after the date of enactment, if it is—

"(a) a liner vessel operated by, or under charter to, a contractor, including a vessel built or to be built under authority granted by the Secretary of Transportation under section 615, eligible for operation or operating under a contract pursuant to this title, with or without operating-differential subsidy, on the date of enactment or in the calendar year preceding enactment;

"(b) a liner vessel operated by, or under charter to, a contractor in international trade on the date of enactment or which has been operated by, or under charter to, a contractor in international trade in calen-

dar year 1985, and not operated with operating-differential subsidy under a contract pursuant to this title;

"(c) a liner vessel under charter to the United States on the date of enactment, or in the calendar year preceding enactment;

"(d) a liner vessel, either under construction or contracted to be acquired on or before February 1, 1986;

"(e) a liner vessel for which operating-differential subsidy payments are authorized under section 623 of this Act;

"(f) a liner vessel which is a replacement for a vessel described in subsections (a) to (e) above;

"(g) a liner vessel constructed, reconstructed, or acquired by a contractor after the date of enactment; or

"(h) a liner vessel other than one described in subsections (a) to (g) above, the operation of which the Secretary determines will further the purposes and policies of this Act.

"SEC. 620. TERMS AND RESTRICTIONS OF OPERATING-DIFFERENTIAL SUBSIDY CONTRACTS.

"The following terms and conditions shall be applied equally to all operating-differential subsidy contracts amended pursuant to section 618 and contracts entered into pursu-

ant to sections 616(a) and 617, which in addition to provision for the payment of operating-differential subsidy shall contain only such terms and restrictions as are set forth below:

"(a) Except as expressly provided in subsections 603 (a)(2), (a)(3), and (a)(4), and this section, contracts shall not in any manner govern, affect, regulate, restrict, or require the operation of contract vessels on particular routes, lines, or services in international trade; nor shall contracts in any manner preclude or otherwise regulate the operation of vessels in international trade which are not contract vessels.

"(b) Contractors shall operate only United States-flag liner vessels between United States ports and foreign ports: *Provided, however,* That contractors may continue to operate foreign-flag liner vessels between such ports during the first two years after entering into a contract under sections 616(a) and 617, or during such additional time as the Secretary may determine is required to complete conversion of such vessels to United States documentation or replacement of such vessels, and contractors may operate foreign-flag liner vessels between ports in United States territories and possessions in the Atlantic Ocean and Caribbean Sea and foreign ports, and foreign-flag feeder vessels as provided in paragraph 4(3) of this Act: *Provided further,* That the Secretary may authorize contractors to enter into voyage charters with operators of foreign-flag liner vessels to operate in the foreign commerce

of the United States under such time limitations and conditions and pursuant to such procedures as the Secretary shall deem to be appropriate. Nothing in this subsection shall preclude space charter agreements with foreign-flag liner carriers to which contractors under this title are or may become parties or subject such agreements to Secretarial approval.

"(c) Except as provided for herein, no contractor, nor any holding company, subsidiary, affiliate, or associate of such contractor, nor any officer, director, agent, or executive thereof, directly or indirectly, shall own, operate, or charter any vessel or vessels in domestic liner service to (1) carry domestic liner cargo between two or more United States ports or (2) otherwise carry domestic liner cargo on any voyage. A contractor which was providing domestic liner services during calendar year 1985 without an operating-differential subsidy contract, or which had express approval during calendar year 1985 pursuant to section 805 or its operating-differential subsidy contract to provide domestic liner services shall be entitled to provide such services in substantial accord with then existing services or, in the case of operators then under operating-differential subsidy contracts, provide service in substantial accord with such express approvals. Any additional domestic liner services by a contractor hereunder shall be established only as permitted under section 805(a) of this Act: *Provided, however,* That no

such permission shall be required for vessels under construction in the United States for domestic liner service prior to January 1, 1986, to be deployed as replacements for vessels operating in domestic liner service. If the contractor operates a domestic liner service authorized in section 605(a), operating-differential subsidy payments shall be reduced in the manner described in that section.

"(d) For the purpose of calculating operating-differential subsidy payments, the Secretary shall employ an index as established in section 603(c)(3): *Provided, however,* That a new base period shall be established no less frequently than each two years.

"(e) For the purpose of computing foreign wage costs, the Secretary shall employ the procedures established in section 603(d).

"(f) The Secretary shall pay operating-differential subsidy equal to the amount estimated promptly on a monthly basis, upon receipt of verification from the contractor in a form satisfactory to the Secretary that (i) the crew wages and fringe benefit obligations of the contractor have been incurred in accordance with its labor contract obligations, and (ii) the contract vessels were in operation in international trade during that month. Each application pursuant to subsection 616(a) or 616(b) shall be accompanied by an affidavit of citizenship. Thereafter, an affidavit of citizenship shall be sub-

mitted by the contractor upon each anniversary of the award of such contract or contract amendment.

"(g) The computation of operating-differential subsidy payments for contract vessels shall be determined based upon the numbers and ratings of United States officers and crews on such vessels, if in operation or existence on the date of enactment. If a vessel is under construction on such date or constructed or transferred to United States-flag subsequent to such date, it shall be eligible for operating-differential subsidy payments on the basis of the numbers and ratings of United States officers and crews approved by the Secretary on comparable United States-flag vessels required for commercial cargo and/or combined cargo/passenger operations, as appropriate, after taking into account the vessel's technology, design, propulsion, and maintenance requirements for the vessel's safe operation.

"(h) Pending the resolution of any dispute concerning the payment of operating-differential subsidy by the Secretary, the contractor shall be paid the full amount the Secretary and the contractor agree the contractor is entitled to receive.

"(i) Notwithstanding the provisions of section 608, contracts and amended contracts under this title shall provide that a contractor may be acquired by another citizen of the United States after commitment by the acquiring party to the

Secretary in a form satisfactory to the Secretary that it agrees to be bound by all of the provisions of the contract and of this Act applicable thereto, and the rules and regulations prescribed pursuant to section 624.

"(j) Every contract vessel shall be manned by citizens of the United States as provided for in section 8103 of title 46, United States Code.

"(k) Every contract vessel for which a contruction contract is entered into after the date of enactment of this Section shall be approved by the Secretary of the Navy as able to be converted economically into an auxiliary naval vessel or as otherwise useful to the United States in time of national emergency. If the Secretary of the Navy determines that additional features are necessary for national defense purposes, the Secretary of the Navy shall pay to the contractor at the time of construction the cost of including such features, and shall pay as incurred by the operator any costs resulting from the addition of such features. Vessels in existence or contracted for prior to the date of enactment shall not be required to have such national defense features.

"(l) Notwithstanding the provisions of section 603(a) or the date of execution of such contract, all contracts entered into pursuant to sections 616, 617, and 618 shall terminate ten years from the date of enactment. If an operator is a party, separately or with one or more affiliated companies, to

two or more operating-differential subsidy contracts on the date of enactment of this Act, it may consolidate such contracts into one amended contract or it may amend the contracts separately: *Provided, however,* That an operator which separately or with affiliated companies has two or more contracts may not elect to amend pursuant to sections 616(b) and 618 less than all of its existing contracts. Upon application and approval by the Secretary, contracts may be renewed for additional periods not in excess of ten years.

"(m) All contracts and amended contracts entered into under section 616 shall be amended or rescinded only upon the mutual agreement of the Secretary and the contractor to the terms of such amendment or rescission. In the event of the rescission of a contract, the Secretary and the contractor shall mutually agree upon a fixed date for the contractor to withdraw its contract vessels from service pursuant to the contract. Upon the date of such withdrawal the further earning of operating-differential subsidy shall cease, and the contractor and the Secretary, other than the making of payments already earned, shall be discharged from any further obligations under such contract.

"(n) Operation of vessels under this section to provide domestic liner service shall be subject to the provisions of section 27, Merchant Marine Act, 1920 (46 U.S.C. 883).

"SEC. 621. PROCEDURES TO ENTER INTO OPERATING-DIFFERENTIAL SUBSIDY CONTRACTS.

"(a) Any operator referred to in section 617(a) or section 618(a) who elects to enter into an operating-differential subsidy contract under section 617 and this section shall be entitled to be a contractor under this title, provided that it submits an application to the Secretary within one hundred and twenty days after enactment of this Act. Any such operator which submits an application within the one-hundred-and-twenty-day period provided by this subsection shall be eligible for operating-differential subsidy payments for operations eligible under this Act from the date of entering into a contract hereunder. The Secretary is directed to award and enter into such a contract not more than thirty days after the application is submitted, and the contract shall be effective as of the later of that date or thirty days after the date of enactment. If any such operator fails to submit such application to the Secretary within that one-hundred-and-twenty-day period, any application it subsequently submits shall be deemed as filed under subsection (b).

"(b) Any operator who satisfies the qualifications set forth in section 617(b) shall become a contractor under this title if it submits an application to the Secretary and the Secretary makes the findings required by section 617(b). Such an operator shall be entitled to operating-differential subsidy payments for operations eligible under this Act beginning on

the later of the date of entering into a contract hereunder or thirty days after the date of enactment.

"SEC. 622. PROCEDURE FOR OPERATORS ELIGIBLE UNDER SECTION 618 TO AMEND OPERATING-DIFFERENTIAL SUBSIDY CONTRACTS.

"(a) At any time after thirty days but before two years after the date of enactment, any liner operator referred to in section 618 may notify the Secretary of its election to amend its operating-differential subsidy contract as provided in sections 616(b) and 618. Such an amendment to the operator's operating-differential subsidy contract shall be effective immediately upon the Secretary's receipt of the notification.

"(b) An operator referred to in section 618 which does not amend its contract pursuant to subsection (a) shall continue to be bound by its operating-differential subsidy contract and the provisions of the Merchant Marine Act, 1936, as applicable.

"SEC. 623. PAYMENTS.

"(a) Except as provided in subsection (b), at no time after entering into a contract or amended contract pursuant to section 616 shall any contractor, including any holding company, subsidiary, or affiliate thereof, be entitled to receive operating-differential subsidy payments for more than the number of qualified vessel ship years of actual operation by said contractor, holding company, subsidiary or affiliate in

the aggregate equal to the number of liner vessels operated in international trade in calendar year 1985 plus an additional one-third of this number of liner vessels, or twenty-three qualified vessel ship years in total, whichever is less: *Provided,* That the ceiling may be through acquisitions of, mergers with, or capital asset purchases from, otherwise unrelated entity which at the time of the acquisition of, mergers with, or capital asset purchases from, an otherwise entity which at the time of the acquisition, merger or purchase is a party to a contract or amended contract entered into under section 616: *Provided further,* That the acquisition, merger, or capital asset purchase must oocur after the date of enactment.

"(b) The Secretary may make operating-differential subsidy payments under contracts entered into under section 621(b) with persons described in section 617(b), and the Secretary may make operating-differential subsidy payments to contractors which entered into contracts and amended contracts under sections 621(a) and 622, upon amendments to their contracts, for the operation of ship years in addition to those permitted under subsection (a) resulting from the operation of additional vessels which qualify under section 619(g). For a period of two years from the date of enactment, any contractor which in calendar year 1985 operated fewer than ten vessels under an operating-differential subsidy contract shall be entitled to priority with respect to application for the

operation of additional vessels, subject to a maximum of twelve contract vessels. The Secretary may make operating-differential subsidy payments under this subsection only after determining (1) that the operation of such liner vessels will further the purposes and policies of this Act, and (2) that sufficient funds are available to make operating-differential subsidy payments on such additional liner vessels.

"SEC. 624. REGULATIONS.

"(a) The Secretary is hereby authorized and directed to prescribe rules and regulations to carry out the provisions of sections 616–625 and section 4 of this Act.

"(b) The Secretary is further authorized and directed to prescribe interim rules, regulations, and forms necessary to carry out the provisions of section 621 and 622.

"(c) The absence or pendency of any interim or final rules or approved forms shall not prevent an eligible person from being able to enter into a contract or contract amendment under this title with the Secretary.

"SEC. 625. DEFINITIONS.

"As used in sections 616–625—

"(1) 'qualified vessel' means a liner vessel wherever built (a) constructed of steel or other acceptable metal, (b) self-propelled by steam or motor, (c) as nearly fireproof as practicable, (d) over five thousand deadweight tons, (e) less than twenty-five years of age

by reference to the vessel's most recent documentation, unless the Secretary finds or has found pursuant to this title that it is in the public interest to grant operating-differential subsidy payments for the operation of such vessel, and (f) documented under the laws of the United States;

"(2) 'contract vessel' means a qualified vessel operated under a contract or amended contract for the payment of operating-differential subsidy;

"(3) 'citizen of the United States' includes a corporation, partnership or association only if it is a citizen of the United States for the purpose of operating a vessel in the coastwise trade within the meaning of section 2 of the Shipping Act, 1916, as amended (46 U.S.C. 802);

"(4) 'international trade' means foreign commerce as defined in section 905(a) of this Act, and commerce between two or more foreign countries including a liner vessel operated under charter to the United States;

"(5) 'liner vessel' means a vessel operated by a common carrier pursuant to an existing operating-differential subsidy contract, or operated by a common carrier on a definite, advertised schedule, giving relatively frequent sailings at regular intervals carrying cargo in international trade, or a vessel under charter

to the United States which could otherwise be so operated;

"(6) 'wage differential' means the difference between the contractor's wage cost including all items of expense incurred as a result of collective bargaining or other agreements inclusive of pensions, welfare, training, unemployment, or fringe or similar benefits and taxes or other governmental assessments on crew payrolls for United States officers and crew and the wage costs of all substantial foreign competitors (on a weighted basis) serving the same trade ranges as the contractor;

"(7) 'Secretary' means the Secretary of Transportation;

"(8) 'contractor' means a person who has entered into a new or amended contract with the Secretary for the payment of operating-differential subsidy pursuant to section 616;

"(9) A 'ship year' is three hundred and sixty-five days of operation of a liner vessel in international trade engaged in the carriage of cargo in the foreign commerce of the United States. It shall be based upon the total number of days for which operating-differential subsidy payments are accrued and shall not include periods of idleness or layup. The number of vessels oper-

ated by a contractor shall not be controlling in the calculation of 'ship years';

"(10) 'domestic liner services' means services by liner vessels between two or more ports in the United States, including Districts, Territories and possessions, thereof; and

"(11) 'foreign-flag feeder vessel' means a foreign-flag vessel owned or chartered by a contractor which engages wholly or partially in the common carriage of cargo between foreign ports for the purpose of providing a transshipment or through transportation service in connection with the operations of a contract vessel or vessels.".

SEC. 4. The Merchant Marine Act, 1936, is amended by adding the following conforming amendments:

(1) Section 510(j) (46 U.S.C. 1160(j)) is amended by adding the following sentence at the end thereof:

"Notwithstanding the provisions of section 503 of the Merchant Marine Act, 1936, as amended, and section 9 of the Shipping Act, 1916 (46 U.S.C. 808), any contractor desiring to sell a qualified vessel, as defined in section 625(1) of this Act, to a person not a citizen of the United States shall make an application to the Secretary and shall offer the Secretary a right of first refusal to acquire the vessel for the National Defense Reserve Fleet. The Secretary shall exer-

cise the right of first refusal or approve the application and permit the proposed sale within thirty days of the date such application is filed.".

(2) Section 603(a) (46 U.S.C. 1173(a)) is amended by adding "(1)" at the beginning thereof and the following at the end thereof: *"Provided, however,* That the Secretary shall not enter into a new operating-differential subsidy contract with respect to the operation of liner vessels except as provided in sections 616 through 625 of this title.

"(2) An operator under an operating-differential subsidy contract entered into on or before January 1, 1986 (including any holding company, subsidiary, or affiliate thereof) which (A) owned or chartered fewer than ten vessels on January 1, 1986, (B) continues to own or charter fewer than ten vessels and (C) has not entered into a contract under section 617 or amended its contract under section 618, may receive operating-differential subsidy for service on a trade route or portion of a trade route which such operator was serving on the date of enactment. Except as next provided, such operator may not use more capacity on such route or portion of a trade route than the greatest capacity it actually employed on such route or portion of a trade route in any calender year between 1982 and 1985.

"(3) An operator may continue any service on an essential trade route served by an operator described in paragraph (2) if

"(A) that operator was operating on that route in any calender year between 1982 and 1985; and

"(B) the level of service provided by that operator is not more than the greatest capacity provided by that operator in any year between 1982 and 1985.

"(4) Any subsidized service in addition to that permitted under paragraph (3) on a route or portion of a route served by an operator described in paragraph (2) shall be authorized only upon compliance with sections 601 and 605(c), and if the necessary actions by the Secretary are taken after January 1, 1986. Nothing in this Act shall be deemed to affect or change existing law or contracts with respect to proceedings under section 605(c) now pending before the Secretary of Transportation or the Maritime Subsidy Board involving an operator described in paragraph (2) above.".

(3) Title VIII (subchapters VIII and VIII–A, 46 U.S.C. 1211–1214, 1222–1228) shall not apply to contracts entered into or amended under this Act except as specifically made applicable in this Act. Except as provided in section 620(b) and this paragraph, section 804 (46 App. U.S.C. 1222) shall apply to contracts and amended contracts under section 616. Each contractor or any holding company, sub-

sidiary, affiliate or associate of such contractor, or any officer, director, agent, or executive thereof, shall be permitted to act as agent or broker for a foreign-flag vessel or vessels and operate a foreign-flag feeder vessel or vessels which would otherwise come within the provisions of section 804, except that the number of foreign-flag feeder vessels permitted for a contractor shall not exceed exceed twice the number of that contractor's contract vessels.

(4) Section 901(b)(1) (46 U.S.C. 1241(b)(1)) is amended by deleting the period at the end thereof and adding the following: "or (3) a vessel is a qualified vessel operated by a contractor pursuant to sections 616 through 625 of this Act.".

SEC. 5. In each of the three years following the date it enters into an amended contract, any operator referred to in section 618(a) which at the date of enactment operated fewer than ten vessels shall be entitled to receive payments equal to $6,000,000 to be used to construct, reconstruct, recondition, or charter eligible vessels or any marine-related equipment.

O

Senator STEVENS. Our first witness is the Maritime Administrator of the Department of Transportation, John Gaughan. And you have with you: Mr. Bowman, Associate Administrator for Maritime Aids; Edward Fitzgerald, Director of the Office of Trade Studies and Subsidy Contracts; and Michael McMorrow, the Acting Chief Counsel. Is that correct?

Mr. GAUGHAN. That is correct, Mr. Chairman.

Senator STEVENS. We are happy to have you here. We would be pleased to hear from you.

STATEMENT OF HON. JOHN A. GAUGHAN, ADMINISTRATOR, MARITIME ADMINISTRATION, DEPARTMENT OF TRANSPORTATION; ACCOMPANIED BY RICHARD BOWMAN, ASSOCIATE ADMINISTRATOR FOR MARITIME AIDS; MICHAEL McMORROW, ACTING CHIEF COUNSEL; AND EDWARD FITZGERALD, DIRECTOR, OFFICE OF TRADE STUDIES AND SUBSIDY CONTRACTS

Mr. GAUGHAN. Mr. Chairman and members of the Subcommittee on Merchant Marine:

I am John Gaughan and I am the Maritime Administrator of the Department of Transportation. It is a pleasure for me to be here this morning to present the views of the Administration with respect to various ODS proposals to promote the U.S.-flag merchant marine.

More specifically, I have been requested to comment on current ODS reform legislation, including S. 2662, which has been introduced by request, and our proposed rulemakings concerning the consolidation of essential trade routes and the elimination of certain restrictions on nonsubsidized voyages by subsidized operators, the so-called General Order 80.

Before I get into more detail, I would like to briefly share the Administration's views with regard to the ODS program and our promotional initiatives. As part of its 1982 maritime policy, the Administration announced that it would honor existing ODS contract, but would not sign any new contracts. This policy reflected the Administration's belief that the U.S. fleet must become more competitive without subsidy to the maximum extent possible.

Today there is apparent agreement within the U.S. maritime industry and in the Congress, as witnessed by this hearing, that the present subsidy system needs to be reformed and restructured. Without such changes, I have serious doubts—and I am not alone in this concern—as to the future of the U.S.-flag merchant marine.

Mr. Chairman, the Administration is committed to meaningful ODS reform. The Administration believes the most effective way to revitalize the industry and increase the U.S. carriage of goods in our foreign trade is: one, to eliminate unnecessary impediments to competitive maritime operations; two, to eliminate restrictive regulatory constraints; three, to support a business environment in which open competition can exist; and four, to permit U.S. fleet expansion through worldwide ship acquisitions.

The Administration believes that implementation of these initiatives will go a long way toward enhancing the competitiveness of the U.S.-flag fleet and setting the stage for a reformed subsidy system that is equitable and minimal in cost and provides the operators with incentives to enhance their competitive position vis-a-vis foreign flag operators.

65-003 O - 87 - 2

To the extent S. 2662 and other legislative proposals would implement such initiatives, they are supported by the Administration. For example, in S. 2662 we support the following initiatives:

A. The authority for U.S.-flag operators to construct or acquire modern, efficient vessels at world market prices. This is essential to modernize tonnage in the private U.S.-flag fleet and increase sealift capacity for the defense of the nation. Large, low cost, fuel efficient ships will allow U.S.-flag operators to compete more effectively in the foreign trades with their foreign counterparts.

B. Immediate eligibility of foreign constructed vessels to transport reserve cargoes under the Cargo Preference Act of 1954.

C. The monthly payment of ODS, rather than only for the voyages completed during the month. We support this approach, as it is in keeping with present business practice in the industry.

D. The concept of increased operating flexibility to efficiently respond to market conditions.

Mr. Chairman, we would be willing to look at any reasonable initiative which would not increase the Government's costs, while at the same time, making U.S. carriers more competitive in the world market. We are also aware that the current legislative effort reflects the recognition by both subsidized and non-subsidized U.S.-flag liner operators of the continuing need for ODS support and unfettered operating flexibility.

However, we believe that S. 2662 and other industry draft legislative proposals do not provide for the meaningful ODS reform that must be undertaken to revitalize the U.S.-flag liner fleet. We are continuing to assess with the industry what system will maximize free market operations, permit U.S.-flag carriers flexibility to compete with foreign carriers, enable U.S.-flag carriers to recapture lost market share, be fair to all U.S.-flag operators, and strike a fair return for the national interest.

Mr. Chairman, the proposed rulemakings on trade routes and General Order 80 are two of the major administrative initiatives we have undertaken to eliminate restrictive regulatory constraints on ODS operators. The trade route proposal would consolidate the present essential trade routes into eight essential trade areas in order to reflect more realistically the current pattern of vessel operations. This very concept is clearly reflected in S. 2662 and earlier industry legislative initiatives which were introduced in the House of Representatives.

The proposed change to General Order 80 seeks to eliminate restrictions on unsubsidized voyages by subsidized operators in order to provide greater operating flexibility for these operators. Under existing regulations, a subsidized operator wishing to enter another trade route outside its ODS contract on a non-subsidized basis must obtain our prior approval, and sometimes the approval of competitors on that route.

The major thrust of this initiative is to provide the subsidized operator more flexibility to operate without subsidy. The operator would have the ability to initiate new service not covered in the ODS contract on a non-subsidized basis.

Mr. Chairman, trade routes and General Order 80 are separate and distinct reforms and should not be viewed as a package. Both were undertaken some time ago. The genesis of these administrative proposals goes back to the early eighties when the Administration began consideration of ODS reform.

Both have been published in the Federal Register, and we are currently giving careful consideration to the written comments we have received on each. Finally, these administrative efforts were never intended to be substituted for meaningful ODS reform legislation.

Mr. Chairman, that concludes my prepared statement. I would be pleased to answer any questions that you or members of the subcommittee might have. I know we have a common purpose in this endeavor and I look forward to working with you and representatives of all segments of the industry towards meaningful reform for the U.S.-flag merchant marine industry.

Senator STEVENS. Let me ask a question and make a comment. It is my judgment that unless we can get this industry together and very soon that we face the possibility of losing 10,000 to 20,000 jobs to foreign competition. Do you disagree with that?

Mr. GAUGHAN. I do not disagree with that, sir.

Senator STEVENS. And would you say that we are really near the peril point in this industry?

Mr. GAUGHAN. I would say that we are very near that peril point, sir.

Senator STEVENS. I want to thank you for your offer. We are going to take you up on it. You said you would be willing to look at any reasonable initiative that would not increase the government's costs which at the same time would make U.S. carriers more competitive in the world market.

I think we will give you an opportunity to do that, I hope this year.

Senator Inouye.

Senator INOUYE. Like you, Mr. Chairman, I have a whole sheet of questions I would like to submit. But if I may, I would like to ask just a few.

Senator INOUYE. We understand your agency has estimated that its contingent liability on existing ODS contracts over the period of their lives to be a figure between $2.2 billion to $2.8 billion. I further understand that if the existing contractors were able to perform all of the authorized services under their contracts, the contingent liability would be about $4 billion.

Can you comment on this?

Mr. GAUGHAN. I think, Senator, that is the range of the numbers as we have looked at them, taking various cuts at what the operating environment is now, and in the furture, and if trade turned up and people performed to the maximum extent possible.

Senator INOUYE. What is the realistic number?

Mr. GAUGHAN. $2.2 billion to $2.4 billion, Senator.

Senator INOUYE. In assessing the difference in ODS costs between this bill, S. 2662, and the ODS contingent liability under the existing contracts, we understand that the S. 2662 cost projections are based on the

assumption of full and immediate implementation of all authority. But we understand that in assessing your existing contract contingent liability, you have made a number of subjective assumptions, whether by company or by ship or otherwise, which caused the analysis to be on a different basis than on S. 2662.

For example, we understand you assume replacement of two ships by one ship in the existing contract assumptions, and yet we note that in the recent MarAd approval of APL's section 615 application you are allowing replacement of six old ships with six new ships.

Where do we stand on this?

Mr. BOWMAN. Mr. Chairman, in fact, in part that is correct. In looking at our contingent liability, where the operators are today and what they are operating and what they are replacing, in some cases we have included an assumption that the ships are replaced, at least with one carrier, on a one-for-one basis.

On the basis of the overcapacity, the difficulties in the trade, and the excess ships that some of the other carriers have, we are assuming based upon our past experience, replacement on a one-for-two basis, and that is built into our numbers and is the basis for the $2.2 billion to $2.4 billion.

Senator INOUYE. And you made an analysis company by company?

Mr. BOWMAN. Yes, that is correct.

Senator INOUYE. And not on an assumption that each company would go two for one?

Mr. BOWMAN. No, sir. We have looked at each company based upon their operating experiences in the past, what they are presently operating, what their cargoes are, what their capacities are, where they are operating the restrictions that they are presently under within their trade routes, what the traffic is on those trade routes, what the likelihood is of the capacity of each of their ships and what they are likely to replace it with in terms of expanding capacity, given the constraints on those trade routes.

Senator INOUYE. You have indicated in your testimony, Mr. Administrator, that this draft proposal does not provide for meaningful ODS reform that must be undertaken to revitalize our liner fleet. Now, can you tell us what is missing or, even better, do you have any legislative proposal that you would like to submit to us?

Mr. GAUGHAN. Senator, I think some of the things that are potentially missing are the necessary disciplines on the operators to hold their operating costs down. As an example, when we have looked at arrangements that have been made with other agencies in the government, MSC—and while I am not saying that those contracts are satisfactory to all—the treatment of wages and so forth, is different and lower.

We would like to see controls, a limitation on what the Government would be expected to pay for a crew size needed for safe operation. That is not to say that individual operators and companies could not negotiate whatever manning arrangement they wanted, but that the Government not be expected to simply continue what had been the situation before; the unions asked, the operators agreed, and the Government paid. There is an example.

Senator INOUYE. Excuse me. Who under your proposal, who will set those limits on crew size?

Mr. GAUGHAN. Under our proposal, certainly one option that has been advanced is trying it to Coast Guard manning standards or a determination by the Secretary of Transportation of an effective crew size.

Senator INOUYE. Please proceed.

Mr. GAUGHAN. There are many elements in S. 2662 that do provide for the type of reforms we are looking for, and I enumerated a number of those in my testimony. When you look at the revisions, the amendments to existing contracts or what would be paid to new entrants, where maintenance and repair and insurance are no longer paid for, but are the costs of the operator, we see that as a step in the right direction.

When we look at trying to hold the costs down, the possibility of reduction in the ship year cap to some lower number than in the bill would have an impact on the cost. And certainly the grant of the $6 million a year to the smaller operators, the elimination of that, if all operators were to take advantage of that, could cost as much as $54 million over three years.

Those are all elements that would go toward reducing the costs.

Senator INOUYE. What would be the effect on the industry itself? You may reduce the cost, but what would be the effect?

Mr. GAUGHAN. I think coupled with the other provisions in the bill, Senator, it would begin to provide the long-term solution to providing effective, efficient, modern carriers.

Senator INOUYE. Do you believe that this bill we have before us will give ODS operators the necessary flexibility that you call for?

Mr. GAUGHAN. Certainly, from my reading of the bill, I see that it would disentangle them from many of the regulatory constraints that they face, primarily with my agency, in making decisions based on business opportunities and what is best for their company, yes, sir.

Senator INOUYE. So you favor that?

Mr. GAUGHAN. I do favor that, sir.

Senator INOUYE. Mr. Chairman, I have many other questions that I would like to submit.

Senator STEVENS. Mr. Chairman.

The CHAIRMAN. No questions.

Senator STEVENS. Thank you very much, gentlemen.

Senator Gorton, did you have any questions?

Senator GORTON. No, thank you.

[The following information was subsequently received for the record:]

QUESTIONS OF SENATOR INOUYE AND THE ANSWERS

Question 1. MarAd's 1984 Study *Reevaluating U.S. Liner Trade Routes* states that the major changes in shipping technology and U.S. trade patterns have allowed operators to serve much broader trade areas than was possible in 1936. "Thus it is the intent of MarAd to consolidate the present 27 essential trade routes with 8 essential trade areas, *in order to reflect more realistically the current pattern of vessel operations.*" In other words, MarAd wants to give ODS operators the needed flexibility to compete in our international trades by restricting them to trade areas.

Inasmuch as S. 2662 does not restrict ODS operators to service on any essential trade route or area, wouldn't it give ODS operators even more flexibility?

Answer. Yes.

Question 2. MarAd is proposing, through legislative action, permission for ODS operators to:

Build low cost, modern vessels in foreign shipyards.

Do away with the formal hearing requirements of Section 605(c).

Through Administrative action, MarAd proposes to:

Substantially remove the requirement that ODS operators restrict their service to particular Essential Trade Routes.

Remove the restrictions on non-subsidized operations by ODS operators.

Question 2(a). Has MarAd done an economic impact study or analysis on how the sum of these proposals would affect the operations of a major U.S.-flag unsubsidized operator, or the smaller U.S.-flag. subsidized operators?

Answer. MarAd has done an economic impact study on each of the proposals—trade route redesignation and the removal of restrictions on non-subsidized voyages by ODS operators (G.O. 80). With respect to trade route redesignation, MarAd prepared the study "Reevaluation of U.S. Liner Trade Routes (Section 211)," dated September 1984. MarAd also did a draft regulatory evaluation on General Order 80, included as part of the General Order 80 docket (R-100).

Question 2(b). Has MarAd done an economic impact study on the effect of either of its two proposed rules?

Answer. Yes. See studies mentioned above.

Question 2(c). Inasmuch as the law requires MarAd to promote the U.S. merchant marine, shouldn't MarAd have some idea supported by economic studies as to whether the totality of its proposals would result in economic disaster for these companies, and the loss of thousands of on-shore and sea-going jobs?

Answer. MarAd has done economic analyses ("Reevaluation of the U.S. Liner Trade Routes (Section 211)" and the draft regulatory evaluation for the repeal of General Order 80) for its rules. These analyses conclude that the proposed rule changes will increase the U.S.-flag participation in the U.S. liner trade.

We have received comments on those analyses regarding the accuracy of that conclusion and are reviewing those comments.

Question 2(d). The total effect of these ad hoc proposals is to change our existing maritime policy and program with respect to liner operations. Isn't Congress the appropriate authority to do this?

Answer. Under Section 211 of the Merchant Marine Act, 1936, as amended, the Secretary of Transportation is authorized and directed to make determinations of essential service in the foreign commerce of the United States and to make rules and regulations that implement the intent of the 1936 Act and that reflect changing conditions in foreign trade and the industry.

Question 3(a). If MarAd repeals General Order 80, so that subsidized operators would no longer need MarAd approval for unsubsidized operations, would subsidized operators still have to meet the requirements of the Snyder Amendment to Section 614 of the 1936 Act, i.e., eligibility is strictly limited to ODS contract vessels as to which the operator has suspended its contract; the vessels must be less than 10 years old; the suspension period must not be less than 12 months; and the operator's financial condition must be maintained at an acceptable level.

Answer. Yes. MarAd's proposal to repeal General Order 80 would terminate MarAd requirements for Agency and other operators' approval of non-subsidized voyages by subsidized liner companies. Repeal of General Order 80 does not change the law, i.e., the Snyder Amendment. Operators of subsidized liner vessels who desire to operate under Sec. 614 will be required to meet its conditions even if General Order 80 is repealed.

Question 3(b). How will MarAd ensure that the requirements of Section 614 are being met, if it repeals General Order 80?

Answer. Operators of vessels will be required to meet the conditions stated in Section 614 even if General Order 80 is repealed. MarAd is currently preparing regulations to implement Section 614.

Question 4. Over a year ago (March 29, 1985) I asked MarAd two questions relating to its proposal to repeal General Order 80.

In its replies MarAd said: "MarAd currently has under review various alternatives to these regulations which could allow greater nonsubsidized services, including total relinquishment of its authority to regulate nonsubsidized service by subsidized operators. MarAd has not yet decided on any particular alternative and *therefore cannot respond at this time to any particular alternative.*"

If I resubmit those questions, is MarAd now in a position to respond in writing for the Record?

Answer. Because alternatives considered are part of the rulemaking process, the Agency cannot answer questions related to them at this time.

Question 4.1(a). Will MarAd be totally relinquishing its authority to regulate *nonsubsidized* service by subsidized operators? For example, Farrell Lines is presently required under its ODS contract to make 44 sailings per year on a route between the U.S. Atlantic Coast and the Mediterranean with three vessels. Wouldn't MarAd's proposal permit a large subsidized company to provide nonsubsidized service on that same route even though a small company like Farrell could not possibly compete? In other words, what control would you have over a large subsidized operator taking advantage of another subsidized operator by using nonsubsidized sailing where a small subsidized company cannot hope to complete?

Answer. MarAd's proposal is to relinquish totally its authority to regulate nonsubsidized voyages by subsidized liner operators under General Order 80, but, of course the Snyder Amendment would remain in full force and effect.

Under the hypothetical posed, Farrell is receiving subsidy for its operation between U.S. Atlantic ports and the Mediterranean while the competing company is not receiving subsidy for that service. On those facts alone it is not self evident why the small company like Farrell could not possibly compete.

Question 4.1(b). Along these same lines, isn't it inconsistent for the Government to support a liner through ODS and then threaten its stability by placing it in an environment in which it can't compete? In that event, won't this proposal create a competitive situation which will threaten the Government's multi-billion investment in ODS?

Answer. Subsidized liner operators presently compete with unsubsidized U.S.-flag operators and with low cost foreign-flag operators. For such an operator to compete with subsidy against other U.S.-flag operators operating without subsidy is not per se "an environment in which it can't compete". Arguments have been presented to MarAd by opponents of the proposed rule that the resulting competition to the existing subsidized liner is unfair. Those comments, and others, including arguments that there is no resulting unfairness, are being considered by MarAd in connection with any further rulemaking.

Question 4.2. Has MarAd ascertained whether it has the resources to ensure that subsidized operators do not underwrite their nonsubsidized sailings with the ODS they receive?

Take the example of a subsidized operator with nonsubsidized services and a nonsubsidized operator with nonsubsidized services which are competing on the same trade route. Wouldn't the subsidized operator have an advantage when the subsidy it receives gives it a cost advantage on its nonsubsidized services, even if the subsidy comes from another route?

In that connection, in the executive summary of MarAd's September 1984 study on the reevaluation of U.S. liner trade routes, it is stated that U.S. subsidized operators already on a route "would retain an advantage (subsidy) over newcomers" providing nonsubsidized services. By the same token, wouldn't a nonsubsidized operator already on the trade route be at a disadvantage with respect to a subsidized operator with nonsubsidized service? In short, I don't understand how you can prevent subsidy from being used to underwrite nonsubsidized service.

Answer. The rationale behind the proposed rulemaking is as stated in the proposed rulemaking: ODS is paid to offset the differential between the subsidized operator's costs for certain items and those of its principal foreign-flag competitors on the subsidized service. For example, a vessel incurs crew wages for a voyage and also accrues subsidy for those wages. At the end of the voyage, the operator must pay the total wage costs. At that time, the operator submits a subsidy bill to the Agency for the terminated voyage. Therefore, there is no extra cash or surplus to direct to another service.

Question 5. I note that MarAd study *Reevaluation of U.S. Liner Trade Routes* was issued in September 1984; and the general references and statistical publications listed in the bibliography for that study are dated 1984 and before.

MarAd's study is, of course, the basis for its proposal to redesignate essential trade routes.

In your judgment, has the situation in our liner trades changed materially in the time since MarAd's study, so that some of the assumptions and conclusions in it need re-examining? For example, since the report U.S. Lines has begun its around the world service; and our Far East trades are heavily overtonnaged which in turn has affected the profitability of major U.S. carriers in those trades.

Answer. Since the study "Reevaluation of U.S. Liner Trade Routes" was issued in 1984, profitability on certain trade routes has deteriorated. Our trade route redesignation proposal is designed to reflect recent changes in shipping technology and U.S. trade patterns, and to give subsidized operators the flexibility to reverse this trend.

Question 6. MarAd's 1984 study on *Liner Trade Route Reevaluation* states that APL concentrates its service in the Pacific Basin (a growing trade area), and that is one of the reasons "this service has been consistently profitable (p. 51)."

MarAd made that statement in 1984. Has that service been consistently profitable since then?

If overtonnaging in that trade area is the reason why it has not been profitable, wouldn't that fact suggest that allowing more ODS operators in the trade would be harmful to the ODS operators already there?

According to statistics I have seen, ODS payments to APL increased from $37 million for FY 80 to $63 million for FY 84. *Yet the MarAd study does not mention this.*

Could it be that this increase in ODS payments was at least as significant a factor as operating flexibility in explaining APL's success? In other words, is MarAd relying too heavily on this factor to justify its proposed trade route designation?

Answer. No. APL's services have not been consistently profitable since then.

Because of foreign overtonnaging and low rates, MarAd does not believe U.S.-flag operators would necessarily move to the Transpacific trades at the present time. Lykes has gotten out of the trade.

ODS payments to APL increased from $44.2 million in 1980 to $64.0 million in 1985. However, APL's gross revenue from its Transpacific operations increased from $609.4 million in 1980 to $855.7 million in 1985. This substantial increase in revenue over the five year period was the result of APL, among other things, having the necessary flexibility to make major strides in intermodal trade between the United States and the Far East.

Question 7. MarAd's 1984 study *Reevaluation of U.S. Liner Trade Routes* states (p. 12): "Expansion of an operator's subsidized service description may have an adverse competitive impact on other U.S.-flag operators. The effect would be similar to that of injecting additional foreign-flag capacity in the trade."

From the standpoint of the U.S. taxpayer I do not believe the effect would be similar.

Because if one ODS operator is free to compete with another ODS operator, U.S. tax dollars would be competing with themselves.

This is not the case when a foreign-flag operator competes with an ODS operator.

Wouldn't MarAd's proposal therefore be an inefficient use of public funds?

Answer. At the present time, there are many trade routes where more than one U.S.-flag operator is present. On these routes subsidized as well as unsubsidized U.S.-flag operators compete among themselves and, more importantly, against foreign-flag operators, who carried 80 percent of the U.S. liner trade in 1985. In fact, U.S.-flag participation was less than 50 percent—the minimum guideline for adequacy—on all essential U.S. trade routes in 1984. It is clear that in these circumstances the payment of ODS to more than one operator on a route is not inefficient in the current trade route structure. Rather, ODS assists operators competing against lower cost foreign competition. Comments to MarAd on the proposed rulemaking contended that the rule would result in an inefficient use of public funds and other commenters contend it would result in a more efficient use of public funds. Those comments are being considered by MarAd.

Question 8. Present law (Sec. 809 (a)) requires that ODS contracts be entered into "so as to equitably serve, insofar as possible, the foreign trade requirements of the Atlantic Gulf, Great Lakes, and Pacific ports of the United States."

How does MarAd propose to meet this requirement in its trade route redesignation with respect to U.S. ports inasmuch as it appears that ODS would only be tied to the coasts of the United States, not specifics ports or port ranges?

Answer. Ultimately, the market will decide which ports and port ranges will be served. If a service is not profitable, MarAd should not continue to force a subsidized operator to service a port or ports in the long run. Since subsidized service is available to all four coasts on equal terms, ports or port ranges must be competitive to attract subsidized operators. In addition, section 809 applies to the consideration of ports or port ranges by the Maritime Subsidy Board in making contracts, not to section 211 determinations, which are made by the Maritime Administrator. A section 211 finding by the Administrator would be limited to a determination of essentiality of trade routes, and would not address changes in contractual subsidized operations. Section 605(c) requirements must be observed prior to any amendment to any ODS contract to reflect the proposed trade routes.

Would there continue to be a minimum sailing requirement, as a condition of ODS; and if so, would it be from a specific port range?

Under the proposal, there would continue to be minimum sailing requirements, but not necessarily from specific port ranges, depending on what contract changes the subsidized operator sought. Because of the development of line-haul/feeder and intermodal services, direct service may be consolidated at load center ports.

Would subsidy be restricted to one of the 8 Trade Areas, or could an operator amend his ODS contract to permit service to more than one trade area?

Answer. Under the proposal, an operator would not necessarily be restricted to serving one trade area; a contract could be amended to allow service to more than one area. Initially, subsidized operators would receive subsidy based on expanded trade areas which encompass their existing subsidized services. Changes to these services within or outside the operator's trade area would be subject to MSB determination pursuant to Sec. 605(c) of the Act.

In either event, before an ODS operator could amend his ODS contract to broaden his service area, would he first have to go through a Sec. 605(c) proceeding, i.e., MarAd must consider adverse impact on other U.S.-flag operators already in the trades proposed to be served?

Answer. Contract amendments for additional service would be subject to Sec. 605(c) hearings, under which the Secretary would determine whether service already provided on an essential service is inadequate, and if additional vessels should be operated in the service.

Under Sec. 605(c), no subsidy contract may be made with respect to a vessel operated or to be operated in an essential service served by U.S. vessel operators, if the effect of the contract would be to give undue advantage between competitive services, unless the Secretary determines that it is necessary to enter into the contract to provide adequate service on the route by U.S.-flag operators.

Question 9. The Navy has consistently said it needs break-bulk vessels and RO/RO's on a priority basis vis-a-vis straight container vessels.

And I believe, one U.S. operator (Waterman) has said that the MarAd study to reevaluate essential trade routes: "maintains a consistent theme of abandoning the non-container trades, even though the containerization accounts for only 44 percent of the U.S. foreign commerce."

What future will Waterman and Farrell have if MarAd adopts its redesignation rules; and how does it fit in with the Navy's national defense needs?

Answer. S. 2662 and MarAd's trade route redesignation proposal pertain to U.S. liner trades, not U.S. trade in general—U.S.-flag non-liner operators are not restricted to specific routes. The share of U.S. liner trade that is containerized has grown from 15 percent in 1970 to 71 percent in 1983. While MarAd's proposal to redesignate the essential trade routes reflects containerization of the major U.S. liner trades, it does not imply that the Agency is abandoning non-container trades—MarAd will continue to honor existing subsidy contracts for non-container trades.

Navy's high priority vessels are not containerships—reflecting a dichotomy between commercially and militarily useful vessels.

The Navy's policy is to meet its sea-lift needs through a combination of the U.S.-flag commercial fleet and the Ready Reserve Force component of the NDRF. Military access to U.S.-flag commercial liner services should increase as U.S.-flag liner companies expand service areas.

Question 10. In making Essential Trade Route determinations, Sec. 211 directs the Secretary of DOT to consider and give due weight to *"the number of sailings and types of vessels that should be employed on such lines or routes."*

How does MarAd propose to do this under its trade route redesignation proposal, in view of the broad flexibility it would give ODS operators.

Answer. Under the proposed essential trade route redesignation, MarAd would continue to carry out its responsibilities under Sec. 211.

MarAd examined current sailings and types of vessels of the U.S. liner operators in the September 1984 study "Reevaluation of U.S. Liner Trade Routes." It should be noted that no changes would be made to an operator's contractual service description until Sec. 605(c) requirements have been observed.

Question 11. According to statistics I have seen, the average ODS per subsidized liner vessel per ship in 1969 was about $666 thousand. In contrast, MarAd's fiscal year 1987 projection for the current program is $3.7 million per ship year, an increase of over 500 percent in 18 years.

Would MarAd's two proposed rule changes reverse this trend?

Answer. The primary reasons for the increase in the average ODS per year per vessel since 1969 are inflation in the domestic U.S. economy and the shift in foreign-flag competition. The consumer price index has increased by a factor of 2.96 accounting for $1.3 million of the increase. The remainder can be attributed to the change in competition from a preponderance of relatively high cost industrial countries such as Norway, the United Kingdom, and Japan to low cost emerging countries such as the Republic of China (Taiwan), Korea, and Singapore. Also, over this same time period, the traditional maritime countries have increasingly employed "mixed crews" employing seafarers from low wage countries in the unlicensed ratings and stewards billets. Since ODS is calculated on the differential between the wage cost of the U.S. crew and the foreign wage cost, the shift to the low cost foreign crew increases the differential.

The redesignation of trade routes would not impact the amount of ODS per vessel; rescinding existing restrictions on unsubsidized voyages by subsidized liner companies would reduce ODS to the extent that the vessel operated is in unsubsidized service.

Question 12. Critics of the current ODS program point out that "in many instances, the Government is actually paying more ODS per ton of cargo under the current ODS system than shippers themselves are paying to move the cargo."

Has MarAd done any economic analysis or study in this regard; and assuming the criticism is accurate, how would the rule changes MarAd is proposing correct this situation?

Answer. MarAd has not done a voyage by voyage comparison of revenues and subsidy per ton of cargo. However, ODS payments were only 9 percent of revenues (ODS plus freight) on a consolidated basis in 1985.

The Agency's proposals to repeal existing restrictions on nonsubsidized voyages (G.O. 80) and to consolidate trade routes, would tend to increase revenues relative to subsidy payments by providing operator with the flexibility to deploy/redeploy vessels in response to changing market conditions or trade patterns.

Question 13. I have two questions regarding the protections afforded by General Order 80. Each of them has several subparts. I would like to submit them, and request that MarAd supply written answers for the record.

1.a. The trade route between the East Coast of the United States and the Mediterranean is an Essential Trade Route, is it not?

Answer. Yes.

1.b. Doesn't that trade contemplate service in both directions so that both United States shippers and consignees will have U.S.-flag service available to them?

Answer. Yes.

1.c. Don't Farrell and Prudential both operate round subsidized voyages in those trades?

Answer. Yes, or at least Prudential used to so operate.

1.d. Over the years hasn't the United States paid those two companies collectively over a billion dollars in ODS?

Answer. Yes.

1.e. Doesn't U.S. Lines (USL) unsubsidized round-the-world service now carry cargo from the United States to a French port (Fos) on that trade route, but not any return cargo?

Answer. Yes.

1.f. And then doesn't USL redistribute the cargo in the Mediterranean with foreign-flag feeder ships?

Answer. Yes.

1.g. Can Farrell and Prudential use foreign-flag feeder ships in the Mediterranean?

Answer. Farrell and Prudential can apply for a section 804 waiver to operate foreign-flag feeder ships.

1.h. Isn't USL a subsidized operator on other trade routes collecting on a company wide basis much more subsidy than either Farrell or Prudential?

Answer. In 1985 U.S. Lines and U.S. Lines (SA) accrued $37.6 and $33.3 million in ODS, respectively. This compares to $17.6 and $14.1 million of ODS accrued by Farrell and Prudential for the same year.

It should be noted that U.S. Lines' ODS contract expires in 1987, and ODS payments to U.S. Lines (SA) will fall sharply from 1985 to 1986 because the company has replaced 10 inefficient vessels with five modern (1983–86 new buildings) low cost ships in its U.S.-Caribbean/South America service.

1.i. Suppose that in this one direction USL service will cause severe economic injury to Farrell's ability to provide this essential round service. Under these circumstances I have just outlined, don't you think that there is a reasonable basis for that assertion by Farrell?

Answer. U.S. Lines' round-the-world service was remanded to MarAd by the District Court for review under General Order 80. MarAd has considered competitive impacts as well as adequacy and inadequacy of U.S.-flag service in its review of U.S. Lines non-subsidized services. As stated in the review (Docket No. S–774) U.S. Lines non-subsidized services are subject to annual review by the Maritime Subsidy Board.

1.j. But if General Order 80 did not exist, Farrell would have no recourse to MarAd to ask that USL's one-way service on that route be regulated would it?

Answer. Under the hypothetical—one directional U.S. Lines service that would cause severe economic injury to Farrell's service—Farrell would have to pursue whatever recourse it had. Presently pending in the rulemaking to repeal General Order 80 is the issue of whether there is any administrative recourse after repeal of General Order 80.

Question 13(2). a. Currently, doesn't General Order 80 apply if, for example, a subsidized operator between the U.S. Gulf Coast and the Par East wanted to deviate off of its route and call the West Coast of the United States?

b. Under such circumstances, is it correct that the subsidized operator would lose some fraction of the ODS otherwise payable for the time he deviates from his normal itinerary to make the off route call?

c. If so, doesn't the subsidized operator end up collecting only 80 or 90 percent of the ODS otherwise payable rather than full ODS?

d. If General Order 80 is abolished, couldn't an operator do this without getting any permission from MarAd or concurrence from an unsubsidized operator serving between the West Coast and the Far East?

e. In those circumstances, isn't the subsidized operator in reality being subsidized for the entire sailing, but at a proportionally reduced amount?

f. Wouldn't that ODS constitute a competitive advantage to the ODS operator in comparison to an unsubsidized operator's service between the West Coast and the Far East?

g. And yet, if General Order 80 is abolished that unsubsidized operator would have no opportunity to attempt to prove to MarAd that there was already sufficient U.S.-flag service and that he would be competitively impacted by the subsidized operator deviating off of his trade route to compete with the unsubsidized operator on his trade routes?

Answer. General Order 80 does not apply to a subsidized voyage on which the vessel deviates from its regular route to make an off-route call. Even if General Order 80 were repealed, the subsidized operator would still be required to obtain permission from MarAd in accordance with contract provisions before it could make an off-shore call unless the contract were amended with appropriate procedure. General Order 80 applies only to non-subsidized voyages.

Question 14. We understand that MarAd has estimated its contingent liability on the existing contracts over the period of their lives to be a figure from $2.2 billion to $2.8 billion. We further understand that if the existing contractors were able to perform all of their authorized services under their contracts, the contingent liability would be about $4 billion. Would you please comment on this.

Answer. Our most recent estimates indicate that realistically MarAd's contingent liability under the existing ODS agreements is between $2.2 billion and $2.5 billion. This is based on our analysis of each operator's vessel requirements and vessel replacement plans in relation to current assumed levels of trade activity and levels of trade activity that reflect a reasonable upswing over the lives of the ODS contracts. While it is true that our maximum liability would be about $4 billion if all the existing liner operators performed to the maximum of their contract service authority, it should be noted that most of the operators have operated at substantially lower levels for a number of years and that some have substantially reduced their fleets.

Question 15. In assessing the difference in ODS costs between S. 2662 and the ODS contingent liability under the existing contracts, we understand that the S. 2662 cost projections are based on the assumptions of full and immediate implementation

of all authority. But, we understand that in assessing your existing contract contingent liability, you have made a number of subjective assumptions, whether by company or by ship or otherwise, which cause the analysis to be on a different basis than on S. 2662. For example, we understand that you assume replacement of two ship by one ship in your existing contract assumptions, and yet we note that in the recent MarAd approval APL's Section 615 application, you are allowing replacement of six old ships with six new ships. It seems to me you're comparing apples and oranges in these types of assumptions. Could you comment?

Answer. Our most recent estimate of existing ODS contingent liability assumes the one-for-one vessel replacement rate for APL as referred to in your question. In addition, other one-for-one vessel replacement assumptions were made based on our evaluation of each operator's potential for increased trade penetration. Where in our view the historical trade patterns of each operator did not indicate a reasonable prospect for increased trade activity, we assumed that as a matter of economic necessity the operator would replace two old vessels with one highly productive and competitive vessel. Overall, our analysis of contingent liability is based on individual assessments of each operator's trades, operating costs, and levels of vessel activity.

Question 16. At the bottom of page 3 of your testimony, you state that the industry draft legislation proposal does not provide for the meaningful ODS reform that must be undertaken to revitalize the U.S.-flag liner fleet. What do you have in mind? Can you tell us exactly what is missing—and, even better—give us as soon as you can proposed legislative language which does so provide?

Answer. We believe a reformed system must be equitable and reasonable in cost to the Government, and should provide operators with incentive to enhance their competitive position with foreign-flag operators. The draft bill substantially exceeds the Government's present contingent liability. Further, the bill does not address getting U.S.-flag carriers on a competitive footing with principal foreign carriers. For example, the total wage and benefits packages of existing collective bargaining agreements need to be adjusted to reflect more reasonable levels of compensation closer to that for principal foreign carriers. Recent union contracts executed between MSC and certain carriers employing commercial union members provide for reductions in crew sizes, pension benefits, vacation allowances, and overtime. We see the reflection of these types of changes in the bill as necessary to the improvement of the competitive position of U.S. operators vis-a-vis their foreign counterparts. We would be glad to work with Committee staff to formulate the appropriate legislative language to effect these changes.

Senator STEVENS. Mr. Tavrow, senior vice president and general counsel of American President Lines; George F. Lowman, chairman and chief executive officer of Farrell Lines; and W. James Amos, Jr., the chairman and chief executive officer, Lykes Brothers Steamship Company.

We have all dealt with one another at one time or another, and we will leave it up to you as to handle your statements. In any event, let me state that, for the record, all statements presented by witnesses today will be printed in full in the record, and we would like for you to summarize your statements. In any event, we want you to handle your presentation the way you feel most comfortable.

Mr. Tavrow, we would like to call on you first.

STATEMENTS OF R.L. TAVROW, SENIOR VICE PRESIDENT AND GENERAL COUNSEL, AMERICAN PRESIDENT LINES, LTD.; GEORGE F. LOWMAN, CHAIRMAN AND CHIEF EXECUTIVE OFFICER, FARRELL LINES; AND W. JAMES AMOS, JR., CHAIRMAN AND CHIEF EXECUTIVE OFFICER, LYKES BROTHERS STEAMSHIP CO.

Mr. TAVROW. Mr. Chairman and members of the committee:

I am Richard L. Tavrow, senior vice president of American Companies, Limited, and its subsidiary American President Lines, Limited, and I am appearing on behalf of American President Lines today.

I would like to submit for the record my prepared statement and summary and provide a brief oral statement at this time. Last summer, Senators Stevens and Inouye asked maritime labor and industry to come forward with a consensus legislative proposal to rejuvenate the declining merchant marine. After many false starts, that day has arrived. S. 2662 is a consensus bill.

We believe this consensus can be transformed into unanimity within the next few days. The bill does basically four things:

Number one, it creates wage parity between all existing U.S.-flag operators and their foreign competition by paying a wage differential subsidy to all U.S.-flag liner operators which are required for national defense reasons to man their vessels with U.S. seamen.

Two, it permits all U.S.-flag liner operators to acquire ships in the world market so that they can compete with the foreign competition.

Three, it permits all U.S.-flag liner operators to operate free of existing regulatory constraints in order to compete with the foreign competition.

Four, it provides certain protection for small operators and permits, subject to limitations, feeders to operate in conjunction with U.S.-manned line haul vessels.

This bill will accomplish the following: First, it will put all U.S.-flag operators into the same ballgame vis a vis each other. This will enable each carrier to compete with one another in the marketplace, rather than in the legislative and regulatory arenas.

Second, it would permit U.S.-flag operators to compete with foreign flag operators and enable U.S.-flag operators individually and as a group to regain a reasonable percentage of world market share.

Third, it will provide jobs for U.S. seamen and transportation security for U.S. importers and exporters.

Finally, it will save the U.S. taxpayers substantial sums by avoiding the need to provide for a substantially expanded standby navy, including both ships and personnel, to meet U.S. military sealift needs in time of national emergency.

This last point deserves emphasis. The cost comparisons which should be made are not between the going out of business ODS program which the Administration envisions and the program outlined in S. 2662. The cost comparison has to be between S. 2662 and the cost inherent in the Administration's approach, namely their ODS costs plus the cost of an additional standby military sealift capacity which will be needed to replace the loss of the commercial sealift component.

As Admiral Crowe, chairman of the Joint Chiefs of Staff, has stated: "In this era of constrained resources, if there were no U.S.-flag merchant marine, it would have to be replaced by a government-owned and operated sealift fleet at considerable additional expense to acquire and operate."

Mr. Chairman and members of the committee, the time is now. A consensus has been reached on a program that is defensible on policy, on budget, on economic, and on defense grounds. Your support and encouragement in the past to develop the consensus has been welcomed.

Is S. 2662 is to become law in this Congress, your active support becomes vital. APL stands ready to give you whatever assistance we can to help you enact S. 2662, with of course any appropriate technical improvements, such as one related to disclosure requirements under Section 801 of the Merchant Marine Act of 1936.

Thank you, MR. Chairman.

[The statement follows:]

STATEMENT OF RICHARD L. TAVROW SENIOR VICE PRESIDENT, AMERICAN PRESIDENT COMPANIES, LTD.

Good morning. I am Richard L. Tavrow, Senior Vice President of American President Companies, Ltd. (APC). Through American President Lines and our intermodal and domestic subsidiaries, APC offers the most advanced point-to-point intermodal liner service in the world. Our fleet comprises 23 vessels, and we make use of up to fifteen transcontinental stack trains per week and an exten- sive domestic surface transportation structure. My testimony today will focus on operating-differential subsidy reform legislation. A written statement concerning the General Order 80 and Trade Route administrative proceedings is being submitted for the record. American President Lines, a subsidized operator, has become widely recognized as a world leader in the development of efficient liner services. Our experience demonstrates that providing the subsidy needed to put U.S. operators on a wage parity with foreign competitors need not create inefficiency. However, our experience also demonstrates that significant reforms are needed in the subsidy system if U.S. operators are to be able to compete equally with foreign competitors. Most importantly, operators must be free to acquire modern, efficient vessels and to deploy their fleets freely and efficiently in response to changing trade patterns and business opportunities. We support S. 2662. By removing the regulatory restrictions which have prevented U.S. operators from competing equally with foreign operators, and by equalizing for all operators the higher costs of U.S. crewing requirements, the legislation provides the competitive equality needed to reverse the decline in the U.S.-flag fleet. The legislation is needed now, because the decline in the U.S.-flag fleet must be halted now.

If carriers are not provided the deregulation and wage parity they need to compete, some will fail, and others will not maintain their vessels under the U.S. flag. The U.S.-flag fleet's ability to provide sealift in time of war or other emergency will continue to erode, requiring expenditures of funds for military sealift assets which will dwarf the cost of a viable operating-differential subsidy program. S. 2662 would assure the U.S-flag fleet's continued ability to perform its necessary sealift role in a cost-effective manner.

S. 2662 is particularly significant because it represents, for the first time, a consensus among operators of most of the U.S.-flag liner fleet, substantially supported by labor, on a program to reform the current subsidy system. Reaching a consensus within the maritime industry is not easy. Great effort has been expended over the past 20 months in the development of S. 2662, and has resulted in legislation we consider equitable and necessary to maintain the U.S.-flag liner fleet.

THE PROPOSAL ADDRESSES CRITICAL COMPETITIVE NEEDS

The legislative proposal supported by the maritime industry contains three critical elements to enable all U.S.-flag liner operators to compete on a fair basis with foreign competitors: as to capital costs, as to service, and as to wage costs.

1) Capital cost parity is necessary to enable all U.S.-flag liner operators to acquire modern, efficient vessels on the world market.

2) Service restrictions which prevent U.S. operators from competing on a parity with foreign vessels must be removed.

3) Because U.S.-flag operators are required by law to crew their vessels with U.S. citizens to assure an available, loyal crew for national defense purposes, they incur much higher wage costs which must be equalized if U.S. carriers are to be able to compete against foreign operators.

Four-fifths of our competition in the U.S. international liner trade now comes from foreign-flag vessels. Enactment of S. 2662 will enable all U.S.-flag operators to retain and hopefully expand this current market share. Without the legislation, U.S. operators will not be able to compete on anything approaching equality in international markets.

DEREGULATION

The deregulatory provisions of the proposed legislation, particularly the authority to acquire vessels on the world market, are critical. Although it was never the intent of the Merchant Marine Act to prevent operators from competing effectively, the existing restrictions in the Merchant Marine Act on vessel acquisition and operations have had this effect.

U.S. building requirements were imposed with the intent that construction differential subsidy (CDS) would be available to assure acquisition of vessels at world market prices. However, the administrative termination of CDS and the escalation of U.S. shipyard costs to three and four times foreign costs has left ODS operators unable to acquire ships.

Trade route restrictions and restrictions on the operation of foreign vessels in support of an operator's basic, U.S.-flag linehaul service were imposed 50 years ago, and no longer reflect current trade patterns and service configurations. Rather, they inhibit U.S. operators from deploying vessels most efficiently and are often relied upon to restrict competition. Moreover, they impose huge administrative and regulatory burdens, without serving a real policy purpose.

The effect of these outmoded restrictions is apparent. The number of U.S.-flag liner companies has declined since 1970 from 21 to 9, and several of the remaining companies are in financial difficulty. The U.S.-flag share of U.S. foreign liner commerce has dipped below 20%. Remaining operators may soon have to consider the alternative of transfer to foreign-flag operations.

Current market conditions make it vital that the deregulatory action proposed in the legislation be adopted immediately. For example, without legislation, competitive vessel acquisition will continue to be prevented precisely when operators need to modernize fleets to take advantage of new vessel technologies and to implement new intermodal and linehaul services, and when a depressed world market makes this possible at low acquisition costs. Forty percent of the vessel capacity on major East-West routes is represented by vessels less than three years old. These new, efficient vessels reduce fuel costs up to 30% and increase labor productivity 400 to 600 percent. U.S. operators prevented from acquiring new tonnage are thus being put at an increasingly serious competitive disadvantage.

Deregulating the ODS system as outlined in the legislation will greatly improve the industry's efficiency. For example, removing U.S. building restrictions would allow introduction of more efficiently-manned vessels, yielding ODS savings of up to $20 million in the first year and over $100 million a year in future years. Allowing more efficient vessel deployment and more efficient use of foreign feeder vessels will also reduce subsidy costs.

The proposed legislation thus provides the deregulation needed to compete, while including provisions for companies which would be affected by an abrupt shift from the current system. Such deregulation is a critical element of an ODS reform package.

WAGE PARITY

Even with substantial deregulation, assistance will still be needed to offset the wage differential between U.S. and foreign-flag crews. Despite the productivity gains of American operators, the wage differential and the competitive disadvantage this creates for a U.S.-flag operator can be expected to continue. Crews from many foreign countries including the People's Republic of China will work for wages that are 15 to 20% of those received by U.S. crews. Competitors from more developed countries, such

as Japan, are reflagging vessels to use such third-world crews, further exacerbating the wage differential. State-owned competitors have also proliferated.

The current experience of U.S. operators bears out the need for equalization of the wage differential. Unsubsidized operations of Lykes and U.S. Lines face a very uncertain future. Sea-Land, which has not previously received ODS, has now recognized the need to obtain a wage subsidy. Moreover, the previous experience of Sea-Land as a non-ODS operator must be assessed with caution. First, its foreign commerce operations are already largely foreign-flag. Sea-Land operates over two dozen foreignflag feeder and linehaul vessels--more than the number of U.S.flag vessels it operates. Second, Sea-Land's earnings have been substantially improved by non-ODS subsidies such as its large Capital Construction Fund deposit, which resulted from the sale of commercially obsolete vessels to the government on terms very favorable to Sea-Land. Third, Sea-Land has a substantial presence in the protected domestic water trades which all other operators serving the foreign trades are, by statute, prevented from duplicating. Sea-Land also has only a very brief history as an independent company. Finally, non-ODS operators such as Sea-Land have not incurred the heavy financial penalties of recent domestic construction for the foreign trades. In the case of APL's most recent construction, this penalty amounted to about $35 million per vessel for three vessels.

There is no basis for a view that providing wage differential compensation will promote inefficiency or prevent operators from modernizing. ODS payments per ton of liner cargo carried declined over 50% in real terms between 1969 and 1982. Estimates of ODS program costs based on dollar amounts which do not account for inflation do not provide an accurate picture of the program.

As a subsidized operator, APL has developed the most advanced and efficient intermodal services in the world. APL pioneered the double-stack liner trains, computerized documentation systems, jumbo containers, and highly developed domestic surface operations. A number of operators have imitated APL's success—10 companies now operate double-stack trains—and APL's productivity advances have been commended by the Senate and by the Maritime Administration. The imitation of APL's services by low-wage foreign operators also shows, however, the need for wage subsidy. Innovation alone cannot make up the wage differential when low wage foreign operators can quickly copy technological advances.

It is important that wage differential compensation be provided, as it is currently, through long-term binding contracts. The investment necessary to provide modern liner services is very large. It is measured in the hundreds of millions of dollars. This sort of investment cannot be expected to be made unless there is certainty that ODS payments will not be disrupted in future years. S. 2662 thus retains the contractual integrity necessary to attract investment in U.S.-flag shipping.

It is also important that full wage parity be provided. Without full equalization of the wage differential, operators will lose the incentive to maintain fleets under the U.S. flag. Attempts to dilute wage differential payments will destroy both the consensus for legislation and the purpose of such subsidy. All operators would be prevented from competing on the basis of parity, perpetuating competitive inequalities. Weakening contractual protections will simply further weaken the fleet.

BUDGETARY IMPLICATIONS OF THE PROPOSAL

In extending ODS to additional operators, S. 2662 will require a modest increase in the amount budgeted for ODS in comparison with the current "going out of business" ODS program. The budgetary impact of the proposal cannot, however, be assessed in a vacuum. Rather, the more than offsetting costs of the alternative to the program--the continued decline and possible elimination of the fleet--must be considered.

The reserve fleet program has incurred greatly increased expenses as the merchant fleet has declined. The Chairman of the Joint Chiefs of Staff noted just two weeks ago that "[i]n this era of constrained resources, if there were no U.S.-flag merchant marine, it would have to be replaced by a government-owned and operated sealift fleet at considerable additional expense to acquire and operate."

Simply maintaining the reserve fleet over the next ten years will cost well in excess of $1 billion--not even accounting for the costs of acquiring and manning those ships. Ready Reserve Force vessel acquisition costs of half a billion dollars are anticipated over the next five years. Crewing reserve ships is already perceived as a serious problem in light of the historic low levels of seafaring shipboard employment, now at fewer than 15,000 billets as opposed to 47,000 in 1969. Development of reserve crews to resolve this shortfall, as is currently being suggested, would add substantial budgetary costs.

It is also well to remember that the current ODS budget already reflects a depleted U.S.-flag liner fleet, and represents the lowest level of support for the fleet in over 30 years. ODS accruals in Fiscal Year 1985 were, in real terms, 14% lower than the accrual in FY 1981. Looking over the longer term, the FY 1985 accruals were 34% lower in real terms than accruals in FY 1975 and 53% lower in real terms than accruals in FY 1965. It does no justice to the U.S. liner fleet to limit its support to current levels, which have contributed to its seriously depressed condition, and to substantially greater reserve fleet expenditures.

CONCLUSION

The proposed legislation would break the policy logjam which has so harmed the U.S.-flag liner fleet, and provide all U.S. operators the legislative environment they need to remain competitive. We would hope that in the forthcoming legislative process the spirit of the current consensus will remain in force. We believe Congress must quickly enact legislation that provides the deregulation and wage differential compensation needed to promote U.S. competitiveness and to assure that the fleet is able to fulfill its necessary military role.

SUPPLEMENTAL STATEMENT

This statement is submitted for the record as a supplement to the testimony on S. 2662 of Richard L. Tavrow, Senior Vice President, American President Lines, Ltd. (APL). It states APL's position on two pending proposals of the Maritime Administration under the Merchant Marine Act, 1936. Those proposals would (i) rescind Marad's General Order 80, thereby eliminating certain existing regulatory restrictions on non-subsidized voyages by subsidized liner operators and (ii) consolidate and redesignate "essential trade routes" under section 211(a) of the Act into trade areas.

Briefly stated, APL's position is that those rulemakings constitute routine actions fully within the existing discretion conferred by statute on the Maritime Administration. In addition, APL believes that it would be most unfortunate if, after half a century, the Congress were to intervene and attempt to prescribe the nature of actions Marad should take in its day-to-day administration of the 1936 Act. Since other commenters at the Committee hearings on S. 2662 articulated a different view of the matter, this statement has been prepared more or less as a response to those commenters' statements, with the thought that this will lend focus to the conflicting views.

The charge has been raised that the two pending proposals would "constitute a gross usurpation of Congress' power to legislate" by making changes that amount to "nothing short of de fact amendment of the Merchant Marine Act of 1936.[1] Quite to the contrary, however:

Each proposal is a normal exercise of administrative authority conferred on Marad by the 1936 Act. In the case of G.O. 80, the agency is merely rescinding an order that it issued—not as a matter of statutory requirement, but wholly on the basis of administrative discretion—more than two decades after the Act became law. In the case of the trade route redesignation, the Act does not itself define "essential trade routes" but rather expressly delegates that authority to Marad.

Moreover, neither proposal would make major new policy under the Act. Rather, each is reactive, i.e., predicated on a recognition that the conditions that were the central basis for earlier administrative action have changed, and that the earlier action should in consequence be rescinded or modified.

A. Elimination of G.O. 80

In light of a number of factors, it exceeds fair hyperbole to assert that the proposed elimination of G.O. 80 would be a gross usurpation of congressional power and amount to a de facto amendment of the 1936 Act.

For one thing, there simply was no G.O. 80 for 21 years after the 1936 Act became law and the subsidy program began. Prior to the promulgation of G.O. 80 in 1957, there was, to be sure, some ad hoc agency supervision of unsubsidized service through "competition" clauses in individual ODS contracts; but until the mid-1950s those clauses were limited to the operation of unsubsidized ships in competition with subsidized ships and had no application to unsubsidized competition with unsubsidized ships.

For another thing, G.O. 80's restrictions on unsubsidized service were clearly not designed to implement any specific statutory restriction on the ability of ODS contractors to provide unsubsidized service. For, compared to the very specific restrictions in the 1936 Act governing the award of contracts for subsidized operations and limiting the ability of subsidized operators to use foreign-flag vessels or to engage in domestic service, the 1936 Act's restrictions on unsubsidized foreign commerce operations by subsidized operators are conspicuous solely for their absence. There simply is not one word in the statute purporting to restrict an ODS contractor's ability to perform unsubsidized service in U.S. foreign commerce. Nor is there any indication in the Act's legislative history of congressional concern with such unsubsidized operations.

Rather than being designed to implement non-existent statutory restrictions on unsubsidized operations, G.O. 80 was promulgated, wholly as a matter of agency discretion, primarily in order to assist the agency in administering the "recapture" provision of the 1936 Act. That provision authorized Marad to recapture a portion of the subsidy monies paid to operators whose profits from subsidized operations exceeded a defined level. The idea was that agency supervision of unsubsidized operations was useful in protecting the Government's recapture rights against possible dilution resulting from diversion of profits or resources to unsubsidized operations.

In 1970, Congress repealed the recapture provision of the Act. Marad did not then take immediate action to rescind G.O. 80, which remained consistent with the agency's then-current practice of exercising close oversight over the smallest details of an ODS contractor's day-to-day operations. That practice, however, has long since been discontinued. Thus, G.O. 80 is a relic left over from a bygone era of regulation. The proposal to eliminate it was "long overdue." [50 Fed. Reg. at 40878.]

In short, G.O. 80 is not in any way central to the scheme of the 1936 Act. To the contrary, the Act contains detailed restrictions on subsidized, foreign-flag, and coastwise operations—but none on unsubsidized foreign commerce operations. Indeed, the Act and subsidy program existed for over two decades without G.O. 80, which was issued as a matter of agency discretion in furtherance of a statutory requirement (recapture) that has been repealed. In these circumstances, it is patently groundless to suggest that the routine elimination of a discretionary oversight order, which implemented a repealed section of the Act, would amount to a de facto amendment of the statute.

B. Redesignation of Essential Trade Routes

Like the proposal to eliminate G.O. 80, the proposal to consolidate and redesignate essential trade routes is a routine exercise of administrative discretion conferred on Marad by the 1936 Act. Indeed, in the case of essential trade routes discretion is expressly delegated to the agency by the statute.

The 1936 Act itself makes no pretense of defining "essential trade routes." Rather, in a routine delegation of authority to an administrative agency, it provides that the Secretary of Transportation "is authorized and directed to investigate, determine, and keep current records of," inter alia, "[t]he ocean services, routes, and lines from ports in the United States . . . which are, or may be, determined by the Secretary of Transportation to be essential . . . ." [Section 211(a).]

Not only is the delegation to the Secretary express, the above-quoted language makes clear that Congress intended that the Secretary exercise the delegated authority to update trade route designations as necessary to conform them to operational realities. Thus, the Act directs the Secretary to "investigate" such routes and "keep [them] current."

Marad's proposal simply implements the statutory mandate that trade route designations be kept current. No one can dispute that the existing trade route designations reflect the traditional trading patterns of the breakbulk operations that prevailed before the advent of containerships and through-intermodal services. Marad's proposal recognizes that

"[i]n recent years there have been major changes in shipping technology and U.S. trade patterns. The development of the line-haul/feeder and intermodal services has allowed companies to serve much broader trade areas than was possible in 1936. Thus, it is the intent of the [proposal] . . . to reflect more realistically the current pattern of vessel operations." 50 Fed. Reg. 9532 (March 8, 1985).

Far from usurping powers not granted to it, then, Marad is merely following Congress' express direction in section 211 to keep trade route designations "current."

The charge has been levied that the two pending Marad proposals [2] to unsubsidized U.S.would be "highly unfair and extremely detrimental flag operators. It can be briefly dismissed.

A. Elimination of G.O. 80

With respect to the elimination of G.O. 80, this allegation proceeds from an entirely false assumption—that unsubsidized operators somehow have a statutory right to be free of unsubsidized competition from ODS contractors. There is no such right. As noted earlier, the 1936 Act contains elaborate safeguards to protect U.S.-flag operators in foreign commerce from unfair subsidized competition and from competition from ODS contractors employing foreign-flag ships, as well as safeguards to protect operators in coastwise service from unfair competition from ODS contractors' unsubsidized domestic services; but there are simply no statutory restrictions designed to prevent an ODS contractor from providing unsubsidized service in foreign commerce. Such competition is fully consistent with the scheme of the Act. Indeed, since the Act imposes no restrictions on the ability of a foreign-flag carrier or unsubsidized U.S.-flag carrier to enter (or exit) a trade, there is no rational basis for insulating U.S.-flag carriers from unsubsidized competition from ODS contractors when the same competition can be, and is, provided entirely at will by unsubsidized U.S. operators or low-cost foreign operators. Moreover, since the level of foreign-flag service greatly exceeds the level of U.S.-flag service on virtually all of the essential trade routes, any increased competition from unsubsidized service by ODS contractors will principally affect foreign-flag carriers.

Nor is there any basis for claiming that any new unsubsidized competition from ODS contractors would be unfair to non-contractors. After all, by definition only unsubsidized competition can result from the elimination of G.O. 80. And in any such competition the non-ODS-contractor would retain substantial advantages over the contractor in terms of operational flexibility, including the flexibility to operate foreign-flag ships. (Sea-Land, for example, operates over two dozen foreign-flag feeder and linehaul vessels—more than the number of U.S.-flag vessels it operates.)

B. Redesignation of Essential Trade Routes

Marad's proposal to consolidate and redesignate trade routes can, in itself, have no effect on competition between ODS contractors and unsubsidized operators. For, as Marad recognized in issuing the proposal [50 Fed. Reg. at 9532], it would still be necessary for an ODS contractor to amend its subsidy contract in order to change its authorized service area to reflect the new trade route designations. And at that time, as Marad again recognized, the provisions of the Act relating to protection of existing U.S.-flag service (including unsubsidized service) from new subsidized competition—including the hearing procedures of section 605(c)—would come into play to the extent applicable. Given Marad's express recognition that its trade route proposal does not permitm these statutory protections, there is no justification whatsoever for retaining archaic trade route definitions—in violation of the statutory mandate that the definitions be kept "current"—based on a highly generalized fear of increased competition between subsidized and unsubsidized operators.

Finally, the charge has been made that the two pending Marad proposals would undercut the consensus support for comprehensive reform legislation, specifically, that Marad would give current ODS contractors two of the "major benefits" that they would receive from the legislation—(i) relief from "the requirement that subsidized services be confined to particular Essential Trade Routes" and (ii) removal of "the restrictions on non-contract operations. [3] Again, the charge is groundless and can be briefly dismissed.

First, as just noted, Marad's pending proposal to redesignate trade routes does not abrogate the provisions of the 1936 Act, including section 605(c), that inhibit new subsidized service in competition with existing U.S.-flag service. The pending reform legisla-

tion would remove such provisions; and that (not revision of archaic trade route definitions that have no independent effect) is the heart of the first element of relief quoted above. The pending administrative proposal simply would not accomplish that.

Second, as to the elimination of restrictions on non-contract operations, the 1936 Act (as noted) contains no such restrictions applicable to foreign commerce. Thus, the thrust of the reform legislation in this regard is not to provide relief from a statutory restriction, but rather to remove any possible basis for arguing that the agency has power to impose such restrictions as a matter of discretion. As such, it is a subsidiary, albeit entirely appropriate, aspect of the reform package.

Third, there are, of course, elements of the reform legislation that all would concede are wholly unrelated to the two pending Marad proposals—· including removal of the requirement that subsidized vessels be built in the United States and removal of restrictions on the use by subsidized operators of foreign-flag feeder vessels. To current ODS contractors, these two aspects of the legislation are enormously important.

In short, there is no basis on which to speculate that final adoption of the two pending Marad proposals would cause subsidized operators to withdraw their support for reform legislation. APL fully supports the legislation notwithstanding its anticipation that Marad will soon adopt these long overdue proposals.

In conclusion, there is no basis to suggest that Marad's pending proposals to eliminate G.O. 80 and to redesignate trade routes would amount to a usurpation of congressional powers and de facto amendment of the 1936 Act. There is no basis to suggest that the proposals would result in unfair or significant harm to unsubsidized operators. And there is no basis to suggest that they would undermine the consensus behind reform legislation.

Although superfluous in these circumstances, it is nevertheless useful to note in concluding that, to the extent the proposed agency actions may increase the flexibility of subsidized operators to provide new, unsubsidized services in competition with foreign-flag carriers, they would further long-standing congressional and executive branch policies to lessen dependence on subsidy and to increase the U.S.-flag share of U.S. foreign commerce.

Senator STEVENS. Mr. Lowman.

Mr. LOWMAN. Mr. Chairman and members of the committee, my name is George F. Lowman. I am the chairman and chief executive officer of Farrell Lines, Inc. Thank you for you invitation to present Farrell Lines' views concerning. One, the draft legislative proposal dated July 18, to reform the ODS program, and two, the impact of the proposed consolidation of essential trade routes and the elimination of General Order 80 of the ODS program reform.

Farrell supports the legislative program in its present form. Farrell's support is tied to enactment of the legislative bill as presently written except, as I will comment hereafter. It is unlikely that Farrell could support the legislation if any material changes are introduced.

The present draft was accepted after important compromises by APL, Farrell, Lykes, Sea-Land, and U.S. Lines; and any substantial changes would adversely affect the industry approach that was adopted by the carriers.

---

[1] July 24, 1986 Statement of Joseph F. Abely, Jr. at pp. 2-3.
[2] July 24, 1986 Statement of Joseph F. Abely, Jr. at p. 6.
[3] July 24, 1986 Statement of Joseph F. Abely, Jr. at 9.

Farrell will be in a position to evaluate MarAd's proposal for consolidation of essential trade routes and modification of General Order 80 when MarAd publishes rules based on consideration of the comments submitted by Farrell and the other parties. Farrell has no objection to the continuation of the administrative process by MarAd, but Farrell cannot take a position on these two important subsidy program matters until Farrell has carefully reviewed MarAd's final proposals.

Due to an oversight, the operators of less than ten vessels are restricted in growth to using 1985 as the base year instead of the date of enactment. We are sure that there is agreement among the members of this panel, that is, those carriers who are supporting this legislation, that an amendment will be sought correcting this oversight, and with that addendum we support the legislative package as presented.

Senator STEVENS. Thank you very much, Mr. Lowman.

Mr. Amoss.

Mr. AMOSS. Thank you, Mr. Chairman.

My name is Walter James Amoss, Jr. I am chairman and chief executive officer of Lykes Brothers Steamship Company of New Orleans, LA, an American flag operator serving a worldwide range of trade routes.

The Merchant Marine Act has served as this nation's maritime policy now for 50 years, and that anniversary, I am sure, will be noted by many who are testifying before you today. It serves to mark how much time has passed during which we have lived with the attitudes and ideas that were incorporated in the legislation when it was passed in the thirties.

The immense degree of change in ocean transportation since the passage of the act now demands substantive revision of the act. A nearly unanimous coalition of carriers and maritime labor have come together to support legislative change contained in S. 2662, and Lykes joins its colleagues in the industry and labor in urging that the Senate Subcommittee on Merchant Marine favorably report S. 2662.

Recognizing also the tenuous prospects for any legislation to rapidly move through the process, Lykes urges the Committee to accept the basis for MarAd to make regulatory change involving essential trade routes and removal of restrictions imposed by General Order 80. The Secretary of Transportation was granted the statutory authority to determine routes deemed essential for the foreign commerce of the United States in the original act under section 210 and 211, and in prior years the Secretary has revised trade routes to meet new developments in transportation as proof in action of such authority contained by MarAd.

MarAd's study leading to the proposed revision of trade routes was accomplished after a considerable period, and wide notice of intent and request for comments. The decision to proceed should not be influenced by adversary pleadings before Congress, but should be left to the Secretary and MarAd.

Thank you, Mr. Chairman.

[The statement follows:]

STATEMENT OF W.J. AMOSS, JR., CHAIRMAN AND CHIEF EXECUTIVE OFFICER, LYKES BROS. STEAMSHIP CO., INC.

Fifty years ago last June 29th, President Roosevelt signed H.R. 8555 into law as the Merchant Marine Act of 1936. The clarity of language and thought contained in the act still shine like a well lighted fairway leading to the goal of a Merchant Marine worthy of an expanding great power. Today, it seems the more remarkable that a Congress composed largely of rural men, tempered by the politics of depression, could put together the blue print that produced a bridge of ships so essential for the coming war and the rebuilding of a torn world.

Lykes endorses the enactment of S. 2662 as a means to enhance the very survivability of the United States Merchant Marine. This bill has the full support of nearly every sector of our industry and provides a strong foundation upon which to base the future of the U.S.-flag liner fleet.

Today, not only must the Merchant Marine Act be revised but it is also vital that its administration and the body of encrusted regulation that has slowed the evolution of an efficient Merchant Marine no less essential to the Super Power of 1986 than it was to the emerging Great Power of 1936, be modified.

For example, the Maritime Administration has proposed the consolidation of essential trade routes to bring a measure of deregulation in keeping with the times and in the face of our largely deregulated railroad and motor carrier industries but no final action on this proposal has yet been taken. This is a sorely needed change from the current narrowly defined trade routes that some operators find themselves lashed to, even as rail and truck deregulation and intermodalism combine to cart off the best of their former market beyond permitted reach.

Another example is the proposal to eliminate the restrictions imposed on currently subsidized operators by G.O. 80. As a subsidized operator, Lykes supported MA's proposal to repeal G.O. 80. Operating flexibility is a paramount consideration to Lykes as a vessel operator. MarAd indicated in its notice that greater operating flexibility would be a major factor in encouraging the competitiveness of subsidized U.S. liner operators. Lykes could not agree more with this position. Such flexibility would enable more efficient use of Lykes' fleet both operationally and economically. Furthermore, such flexibiity would put all subsidized operators on a more equal footing with foreign competitors who have the flexibility to employ their vessels on any U.S. foreign trade route however they wish, whether for just one voyage or in a dedicated service. Accordingly, this reason alone is sufficient in our opinion to support MarAd's proposed action.

Lykes supported the repeal of G.O. 80 which was initially adopted by the Maritime Administration as a result of a discretionary policy decision based upon the industry environment as it existed in 1957. Needless to say, that environment, which predated the Container Revolution, has changed radically. However, not only has the technology of the liner industry changed, but so has the implementation of the subsidy programs under the Merchant Marine Act, 1936. As this committee knows, the CDS Program has not received new appropriations since 1980 and there are no future funds budgeted. Without a reversal of administration policy or new legislation, future new vessels required by subsidized operators to upgrade their fleets will be built in foreign yards and without S615 authority will otherwise be ineligible for subsidy. The operation of such vessels would, consequently, constitute unsubsidized operations under G.O. 80 and be subject, therefore, to the restrictions and requirements thereof. This, in fact, is the very problem that U.S. Lines is facing today with its ECON ships. U.S. Lines' operational innovations are being threatened by discretionary regulations adopted during the break-bulk era. Lykes too will soon be faced with the need to operate foreign built vessels in commercial service.

To be sure, appropriate deregulations for the maritime industry would be to eliminate the trade route concept entirely, and merely require that subsidized operators maintain liner service in U.S. foreign trade with certain numbers of vessels, as indeed any foreign flag operator is free to do. That is the thrust of S. 2662 which further provides for the inclusion in the operating differential subsidy system those operators currently providing unsubsidized U.S. flag liner service in the U.S. foreign trade. Lykes applauds this proposal to deregulate the liner industry and extend subsidy to additional operators in need and we are prepared to accept sacrifices that will substantially reduce the cost of our authorized subsidy to help support the cost of adding new applicants. Lykes firmly believes that the changes proposed in S. 2662 will produce a better American-flag Merchant Marine committed to unity rather than the current havoc created by adversary positions on every issue. We urge this committee to favorably report S. 2662 and assure you we will work diligently to further its passage in the Congress.

The passage of S. 2662 will be worked for and prayed for, but labor is often for naught and prayers are sometimes unanswered. We believe this committee should now recognize the plight of the prisoners of the 1936 trade route concept. Their competitors may wish them gone but clearly the Maritime Administration recognized the change of market that has reduced the ability to survive in many of these narrowly defined trade areas. Need is the basis for this change, but need can only be met by authority and this committee has expressed concern over MarAd proceeding with its plan without congressional approval. We believe the framers of the Merchant Marine Act foresaw the need for change and provided the basis for administrative action to accomplish such change and set forth our views in greater detail as follows:

AUTHORITY TO REDESIGNATE TRADE ROUTES

A. Statutory authority

Section 210 of the Merchant Marine Act, 1936, as amended (the "Act"), authorizes the Secretary of Transportation, acting by and through the Maritime Administrator (the "Secretary") (Pursuant to Reorganization Plan No. 21 of 1950), to develop a privately owned U.S. merchant fleet to provide shipping service on all routes essential for maintaining the flow of the foreign commerce of the United States. Section 211 of the Act directs the Secretary, in carrying out these objectives, to "investigate, determine and keep current records of (a) ocean services, routes and lines from ports in the United States, or in a territory, district or possession thereof, to foreign markets, which are, or may be determined by the Secretary of Transportation to be *essential* for the promotion, development, expansion and maintenance of the foreign commerce of the United States . . . [emphasis added]." Section 211 of the Act further directs the Secretary in reaching his determination, to consider and give due weight to the costs of maintaining each of such steamship lines, the probability that any such line cannot be maintained except at a heavy loss disproportionate to the benefit accruing to the foreign trade, the number of sailings and types of vessels that should be employed in such services or on such routes or lines, and other facts and conditions that a prudent businessman would consider when viewed in light of the additional intangible benefits afforded the U.S. foreign commerce and the national defense.

In accordance with these responsibilities, the Secretary has dutifully undertaken to review the changing patterns and development of the U.S. maritime commerce and has rationally concluded the need to consolidate the current trade routes and designate trade areas to promote the development of an efficient and modern U.S. merchant fleet. *Reevaluation of U.S. Liner Trade Routes (Section 211)*, Maritime Administration, September 1984 (hereinafter "The Trade Route Study").

B. Prior redesignation of trade routes

The Secretary has previously consolidated trade routes in administering his responsibilities.

In 1966, the trade area concept was adopted for trade between the Great Lakes Area and foreign ports. Five trade areas were designated based on the Secretary's investigation to determine: (1) Whether the traffic warranted essential trade routes for direct service between the Great Lakes Area and foreign countries; (2) whether overseas foreign areas could be best served by a continuation of the extension of the existing North Atlantic routes into the Great Lakes; and (3) whether insufficient interest was shown or there was such a lack of traffic potential as not to warrant continuing the essentiality of any or all of the development routes. The Secretary concluded, on the basis of the large volume of cargo and its annual growth and other facts of record that: (i) Only four percent (4%) of the Great Lakes cargo was being transported on U.S. bottoms; and (ii) transportation costs of U.S. Government-sponsored cargo was artificially high due to transportation through east coast gateways, that the Great Lakes trade had matured to a level requiring the designation of direct trade routes with foreign areas. As a result, the Secretary determined that greater operational flexibility would be accomplished by consolidating existing Great Lakes trade routes in five separate and essential trade areas (*Great Lakes Foreign Trade Routes*, MA No. S–173, 6 S.R.R. 575 (1965), 7 S.R.R.R. 385 (1966).

Similarly, in 1961, the Secretary found and determined services on the consolidated trade routes of 5, 7, 8 and 9 to be essential within the meaning of Section 211 and consolidated these trade routes. The determination was based upon the following:

REEVALUATION OF TRADE ROUTES

The Secretary has responsibly reviewed the U.S. foreign trade and has given notice of his intent to consolidate existing trade routes and designate trade areas in keeping with the objectives of Section 210. The following factors were reviewed and analyzed as the basis of the Secretary's section 211 determination: (1) The development of fully cellularized containerships; (2) the utilization of line-haul deployments; (3) the development of intermodel networks; (4) trade factors shared by the more profitable U.S. liner operators, such as modern fleets, operations in growing trade areas operating flexibility; (5) trade factors which plague less successful line operators, such as trades with less developed foreign areas and inefficient older fleets; and (6) the general decrease in percentages of U.S.-flag participation in liner trades.

The trade route concept in view of the development of the industry leads to inefficient utilization of shipping resources. For example, excess tonnage cannot be transported by operators outside their assigned trade routes, the number of ports at which operators call is limited, and unscheduled port calls to pickup unanticipated cargo cannot be made. Each of these instances represents potential loss revenues by U.S. operators to foreign competitors with no such restrictions.

The need for broadening the currently restrictive trade route designations has long been recognized by all concerned with ocean transportation. In 1977, the Merchant Marine Subcommittee conducted oversight hearings with respect to the U.S. Merchant Marine over a period of 14 months. With respect to the issue of modification of trade routes, the subcommittee recognized that by tying subsidized liner vessels to specified routes, the trade route concept: (1) Limits operator flexibility; (2) reduces competition between subsidized carriers; and (3) results in overtonnaging by preventing operators from shifting vessels to other routes or making additional off-route calls when cargo is available. The subcommittee concluded that even if cargo volume is high, efficient utilization of shipping resources is hindered. As a result, it recommended that the Secretary initiate a study to broaden the trade route concept (see *Report of Subcommittee on Merchant Marine*, Serial No. 94-N, PP. 87-88 (1977).

As noted in the aforementioned "Trade Route Study" major changes in operators in recent years, especially "replacement of conventional breakbulk vessels with fully cellular containerships, use of line-haul/feeder deployments and the development of intermodel networks," justify a consolidation of the currently designated trade routes.

Lykes supports the conclusion of that study that:

"Since containers can move inland via rail or truck, operators have established intermodal networks to serve the U.S. hinterland as well as multiple coasts. For instance, the extensive use of rail links in the U.S.-Far East trades resulted in a shift in cargoes from U.S. Gulf to Pacific ports. Similar intermodal networks have been established overseas in industrialized areas. Thus, in many cases, liner operators provide transportation services from the origin to final destination as an integrated service." Trade Route Study, P. 3.

In fact, I set forth in recent testimony before the Maritime Administration the impact that these changes in trade and service patterns have had on Lykes. I reviewed the progression of the trade on Lykes' traditional gulf ro' es from the inception of its subsidized operations to the environment created by today's deregulated domestic transportation environment as follows:

"Lykes' oldest services, including lines C, D, and E, are based primarily or exclusively in the Gulf of Mexico. When these services were designed, Gulf ports were the natural gateway for cargo flowing from a vast hinterland in the mid-section of the United States roughly co-extensive with the Mississippi Basin, and including the agricultural area that supplied most of the grain, cotton, and other major agricultural exports of the United States; the industries of the Midwest, supplying much of the country's manufactured exports; and the oil-producing areas of the Gulf, supplying petroleum products and petrochemicals. The rate structures of the U.S. inland waterways carriers and the railroads were favorable to the Gulf ports as gateways for these movements.

"Since Lykes' Gulf services were founded—and even since the signing of Lykes' latest long-term subsidy contract in 1978—the most far reaching developments in this country in transportation have taken place, and their evolution has dramatically altered the transportation concepts embodied in our trade route designations, established in the era of 1936.

"The developments I refer to are the deregulation of domestic transportation, which has eliminated the designated tributary hinterlands for each coastal area established through the ICC's former rate territory system. Deregulation now permits domestic rail and truck carriers to price without ICC control and to base their rates

to seaboard on market and volume factors. This sweeping conceptual change has resulted in a massive shift of general cargo originating in the Midwest away from Gulf ports to ports on the East Coast and West Coast. Intermodalism has been a natural fit with this change, with the result that liner carriers nailed to Gulf-only trade routes have been unable to follow their shifting cargo markets. In effect, cargo moving today from the U.S. Midwest overseas in an easterly direction to Europe, the Mediterranean, and the Near East enjoys domestic rate incentives to move via the East Coast.

"Another irony of the rigid and outdated trade route designation for U.S.-flag subsidized carriers is the fact that our foreign competitors are free to serve any combination of ports, at will, in order to construct the most efficient employment of their ships. As Gulf markets declined in the past decade nearly all foreign lines have made the natural combination of Gulf and Atlantic routes or eliminated Gulf service by direct call and offered land bridge service from Atlantic load center ports.

". . . Markets have migrated, but thus far trade routes have not been allowed to follow."

In fact, the Maritime Administration has been even more explicit in its study wherein it states that:

"The advent of unrestricted landbridge service has made the designation of U.S. coastal districts in trade routes, for the contiguous 48 States, superfluous. That is, U.S.-flag operators restricted to one coast compete via rail links with those on other coasts. Thus, trade routes can be differentiated by foreign areas alone."

On the basis of its review and the determinations set forth therein, the Secretary should proceed to adopt and implement the consolidation of trade routes as specified in its notice of March 5, 1985, in order to provide subsidized operators the opportunities they require to improve the efficiency of their operations in order to fully participate in today's transportation systems. With the Congress, the Maritime Administration and the industry all recognizing the crucial nature of this issue, it is time to act and act expeditiously.

AUTHORITY OF THE SECRETARY AND THE MARITIME SUBSIDY BOARD TO AMEND ODS CONTRACTS IN LIGHT OF SECTION 211 DETERMINATION

Upon the Secretary's Section 211 determination becoming final, it is proposed that the Secretary and the Maritime Subsidy Board make all required findings to permit the Secretary and existing subsidized operators to amend their ODS contracts in keeping with the Secretary's Section 211 determination.

The Section 211 determination on essentiality of a trade route is made by the Maritime Administrator, whereas the Section 605(c) determination of adequacy of service is made by the Maritime Subsidy Board. Nevertheless, the Secretary of Transportation is ultimately responsible for all maritime subsidy decisions made under the Act, and as the Secretary has recognized it is common sense to endeavor to harmonize the Section 211 and Section 605(c) determinations. *Atlantic Express Lines of America,* No. S-124, 2 SRR 725, 730 (1963). Even though the Secretary's Section 211 determination is not equated to statutory inadequacy under Section 605(c) (*States Marine Corp.—Tri-Continent Service,* 5 P.M.B. 60), it has nonetheless been held that . . .

"[What] the Subsidy Board can do and *should do* in a Section 605(c) proceeding is to consider such information as is available to it, which is factually relevant to the issue. Thus, the Subsidy Board should take note of any previous determination under Section 211, particularly one pertaining to the same trade route at issue." [Emphasis added] . . . . (*Atlantic Express Lines of America,* supra at 731 (1963).

The Section 211 determination, if made, will imply a *standard of required service,* I. E., that the trade area concept is "essential" to the promotion of the U.S. Merchant Marine fleet. In reaching this Section 211 determination, the Secretary will have conducted a thorough investigation of the inadequacies of the current trade route concept in light of the development of the U.S. Merchant Marine and changing trade patterns. Current data and information compiled by the Secretary in making this Section 211 determination include: (1) The extent of unused capacity on vessels now operated by U.S. subsidized carriers; (2) the extent of U.S. participation in each foreign trade area; and (3) an analysis of the extent and type of competing foreign carrier services. Moreover, the Secretary has solicited and received public comment.

All of the compiled data and public comments considered by the Secretary in making the required Section 211 findings establish virtually the same information which the Subsidy Board would consider in making a determination concerning adequacy of existing service. Absent cause for further proceedings under Section 605(c)

the Board, upon consideration of the relevant data now available to it, can make the determinations required to permit amendment of existing ODS contracts in accordance with the Section 211 determinations.

Inherent in this Section 211 determination is the issue of "adequacy" of existing service, the Subsidy Board therefore will be faced with two choices: Either to harmonize its findings with the Section 211 determination or to explain and clarify any obvious conflict between the Section 211 determination and the contractual restrictions which presently pertain. In the first instance, due process should not require any further notice or hearings. Procedures provided for in the notice of March 5, 1985, should suffice. Since issues of adequacy have been properly noticed for comment to date, no further proceeding should be required.

Pursuant to Section 204(b) of the Act, the Secretary is authorized to adopt all necessary rules and regulations to carry out the powers, duties and functions vested in him by the Act. Under this grant of authority, the Secretary has the broad discretionary power to deal with changing technological and economic conditions of the maritime industry.

Moreover, all subsidy contracts provide "if the Secretary of Transportation shall determine that a change in an essential service which is receiving an operating differential subsidy under this title is necessary in the accomplishment of the purposes of this Act, he may make such change upon readjustment of payments to the contractor." Thus, clearly the changing of the subsidized service in any existing ODS contracts is authorized by the explicit terms of the contract. Furthermore, all ODS contracts provided that they may be amended by the mutual consent of the parties.

It is understood by Lykes as specified in the notice of March 5, 1985, that the Government will likely require that any amendment to the ODS contracts not result in an increase in the cost of the ODS program. It is our expectation that the adoption of the revised trade area proposals and the consequent contact amendments should not only satisfy this requirement but, in fact, the Government's subsidy exposure may be reduced.

Senator STEVENS. Thank you very much. I think Senator Inouye and I should say for the record that we appreciate the time that you and others have spent meeting with us in the last year and a half.

APL in the past, Mr. Tavrow, has taken the position that Congress could not modify the existing ODS contracts because of the full faith and credit clause of the Constitution. This bill attempts to avoid that issue by leaving the decision to retain current contracts to the operators.

Do you feel comfortable with the bill the way it is drafted?

Mr. TAVROW. Yes, I do, Mr. Chairman. Actually, the bill provides braces and a belt. It says as I read it, that an existing ODS operator can keep its existing contract, or it can amend that contract to benefit from the deregulation provisions of the bill, or it can enter into a new contract. But however the operator decides to go, all three of those approaches result in a contract, which as provided in the bill, is subject to the full faith and credit of the United States. Consequently, I feel comfortable that APL will both be able, in effect, to retain what we believe, and you correctly describe, are viable existing ODS rights, as well as to benefit, as will all the rest of the liner operators, from the deregulatory provisions of the bill.

Senator STEVENS. Mr. Lowman, as I understand your statement, you are reserving the right to judge the results of the two administrative actions relating to the subsidy program until MarAd reaches a final decision.

Mr. LOWMAN. That is correct, Mr. Chairman. The study, the MarAd study was published in 1984, I believe, and thereafter all of the carriers were invited to make comments. We have all made comments, and we have had no indication of what the results of those comments, if any,

are; so what we are saying is that we generally support the concept, but if there are any modifications or changes, we would like to know about them before giving our final and complete approval.

Senator STEVENS. Do you think that those decisions are essential before this legislation would be enacted?

Mr. LOWMAN. Well, if the legislation is enacted, then there is no problem with respect to General Order 80 and the designation of trade routes, because all of those areas go right out the window.

Senator STEVENS. Mr. Amoss, it is my understanding that Lykes is very interested in the relaxation of the principles of General Order 80 and the consolidation of trade routes. Is that your primary goal?

Mr. AMOSS. Well, our primary goal is the passage of the legislation, but it is almost an equal goal, because if the legislation is either delayed or not passed we must get through the determination and hopefully a favorable one on General Order 80 and the revision of trade routes to recognize what has taken place in transportation in this country that has affected the flow of cargo to our ports and port areas and the overseas areas.

Senator STEVENS. But if we can get a bill essentially similar to S. 2662 enacted, you would accept that alternative?

Mr. AMOSS. Absolutely, but I cannot put all bets on that alternative alone.

Senator STEVENS. I understand, but it is not an either/or proposition.

Mr. AMOSS. Yes, I hope you understand. However, the consequences of no bill and no enactment are very serious not only for Lykes but for other operators as well.

Senator STEVENS. I think we do understand that.

Senator Inouye?

Senator INOUYE. Mr. Chairman, put another way, am I correct to assume that if MarAd repealed General Order 80 and redesignated the 27 trade routes into eight trade areas, and if you were permitted to build foreign, your support for this measure would be diminished?

Mr. AMOSS. No, sir, it would not be. I have a commitment that is deeper than just the commitment of my company to the proper operating conditions that it ought to have, and that commitment is to the American Merchant Marine, in which I have immersed 39 years of my life, and it is just entirely too much a part of me not to want to do the whole job, and we are deeply committed to S. 2662.

Senator INOUYE. Do the other two have the same——

Mr. LOWMAN. We share that feeling, Senator Inouye, that we would like to see the bill passed in its present form.

Mr. TAVROW. I agree entirely, Senator, with the statements of both my colleagues.

Senator INOUYE. According to statistics, the average ODS per subsidized lines vessel in 1969 was about $666,000 per ship year. In contrast, MarAd's fiscal year 1987 projection for the current program is $3.7 million per ship year, an increase of about 500 percent. Do you believe that this measure will reverse this trend? Do any of you have thoughts on that?

Mr. TAVROW. Senator, I think there is one point that should be emphasized, and that is the significant difference between ships that sail today and are being built and will sail tomorrow from those ships that were deployed by carriers in 1969. Because of modern technological innovations, the size of crews will substantially decrease, so that the total subsidy bill will to decrease over time. Also, with respect to the dramatic changes between 1969 and today, clearly crews have been large and inflation and the cost of maritime labor have increased, but we see a decline as companies are allowed to improve their fleets by building new ships, and we see that the average figure that you gave for today will begin to fall as we get fewer people aboard those ships.

However, that is not to say that we should press down to the barest minimum. We obviously need those size crews which can both economically and safely man the ships.

Senator INOUYE. Do you think the Coast Guard manning levels are sufficient?

Mr. TAVROW. I am hardly an expert in this area, Senator, and I am not entirely sure what the Coast Guard requirements would be for each type of vessel. However, there are requirements relative to international admiralty law which have to be maintained, as well as the necessities of complying with the Coast Guard manning levels and, of course, the collective bargaining process with our friends in maritime labor.

But I think there is developing a consensus among those three groups, the operators, labor, and the Coast Guard, as well as developments in admiralty law, which result in optimum efficiency from a diminished size crew, diminished from vessels being manned in the past by 40 or 45 people.

Mr. LOWMAN. May I comment on that question, Senator Inouye? The Coast Guard is basically interested in safety and the operational aspects of the ship. Depending upon the trade, there are many requirements that go beyond just those simple requirements, and accordingly there may be some need of additional personnel over and above the Coast Guard designation.

However, it would appear that as we become more efficient and effective throughout the entire fleet, there will be a gradual reduction. That, of course, is a negotiated problem that has to be worked out with everybody concerned.

One other comment I would like to make. The comparisons you gave us between the 1969 and the current figures are, of course, not based on constant dollars, so the relationship is really closer than one would gather from that observation.

Mr. AMOSS. Senator, I would like to comment a little bit on the differences reflected by subsidy per vessel cost in 1968 and 1969, whenever it was, and 1987, a 20 odd year period. In the first place, the competition that formed the relative difference in operating costs in the sixties was largely in the developed major maritime countries, Europe, Italy, Great Britain, and Japan beginning to emerge in that time, but today the difference in cost is largely measured against Asia, Southeast Asia, China, Taiwanese crews who are major competitors on most trade

routes, and that is a vast difference, of course, the cost of living in those countries versus Europe, versus the United States.

The other side of it is, of course, the progress of inflation over 20 odd years. Put together, they do represent some path as to how the differences could get so big. The other point that is very important to bear in mind is that a $3.7 million per year estimate for a current ship in the American Merchant Marine is the highest cost that—I am certain of that, the highest cost of operation of any of the ships in the American Merchant Marine, and it represents older ships with crews in the high thirties and forties that were not automated, that are completely geared or do not represent any of the great changes in maintenance and in management that you have in new ships.

And that, I guess, the paradox of that is that if we stay right where we are and do not change the Merchant Marine Act, and do not allow the operators to renew their fleets, we will continue to pay these kinds of wages for a declining merchant marine, and ultimately we will have nothing except the money that we have spent in past years.

A new ship today with a 21-man crew would require a subsidy of about $2.5 million or more than $1.2 million reduction in that proposed figure, and that is what we need to be getting to so that we can have a merchant marine that is vital, that is renewed, and that brings the cost down, and we can do it.

Senator INOUYE. As all of you know, the ODS program is raw meat for maritime critics, and we have all read their criticisms, for example, a recent one is that in many instances the Government is actually paying more ODS per ton of cargo under the current ODS system than the shippers themselves are paying to move that cargo.

Now, I am not certain that criticism is accurate, but if it is and if this bill were passed, would the bill correct that situation?

Mr. AMOSS. I certainly think it would, because we are operating old factories, and we are locked into those old factories. We cannot build. And we must have the means to become efficient, and therefore we have to be able to replace our fleets.

I definitely think that we can bring the cost of ODS significantly down per ship and extend the program, and that is the whole basis of S. 2662, is to find a means to reduce the cost so that at an appreciably lower cost per ship thanwhat is presently being estimated as the cost of the program by MarAd we can extend this program to significantly larger numbers of operators, and thereby guarantee a more flourishing, modern merchant marine with all liner operators on a level playing field, as has so often been referred to as the basis for these changes.

Mr. TAVROW. Senator, I might also add that in preparing the prepared remarks which I am submitting for the record, we have actually taken a look at those ODS accruals, and we found that the ODS accruals in fiscal year 1985 were in real terms 14 percent lower than the accrual in fiscal year 1981, and looking over the longer term, the fiscal year 1985 accruals were 34 percent lower in real terms than the accruals in fiscal year 1975 and 53 percent lower in real terms than the accruals in fiscal year 1965, which, of course, points out the effect of inflation on the dollars involved in those comparisons.

Senator INOUYE. Under the present law ODS is conditioned upon and justified in the public interest upon a finding that it is necessary to maintain adequate U.S.-flag service on trade routes essential to the foreign commerce of the United States. Now, under this bill no such finding is required, plus ODS becomes an entitlement program, and ODS recipients can offer a line of service any time, anywhere, as long as that service is in the foreign commerce of the United States and do not include present trade route 18.

What therefore is the public interest justification for ODS under this bill?

Mr. LOWMAN. Well, Mr. Senator, I believe I could answer or try to answer that question to this effect. The passage of the bill is to help and encourage and develop the merchant marine for the purposes of, one—commercial traffic, and two—defense. These proceedings will permit the merchant marine to grow and develop and to expand without the limitations and the restrictions under which it presently operates.

So, the net result will be that although the subsidy is not limited to particular areas, particular trade routes, it will be beneficial to the public in that all of the basic purposes of the merchant marine will be served and served much more effectively than they are at the present time.

Senator INOUYE. Do you agree with that?

Mr. AMOSS. I do agree with that, and I would like to comment on it this way. The arbitrary designation of essential trade routes and the locking of carriers into those trade routes has failed miserably to recognize the changes that have occurred in markets, in strategic relationships that the United States has with countries that form the basis of our trading and have left operators stuck in trade routes where the traffic has declined so much that they have no other option than to go out of business, go bankrupt, and that has happened on a number of occasions.

What we are trying to do here is to deregulate that portion of the industry which with the same kind of deregulation we have done in 1981 for truck and rail, and let the business climate dictate the decisions of businessmen as to where to operate liner services in the foreign commerce of the United States.

I believe that we all have faith that if there is business out there, that businessmen are going to do that business if they have the means to be in the business, and I would say to you that trade routes that are essential to the United States are going to get served up to the capacity and needs of shippers by virtue of there being business there and the operators having the freedom to go there. As it is now, in cases where business is developing in new areas, the American flag subsidized operators do not have the freedom to go there, and it can sometimes take as much as 5 or 6 years to get through the hearings and all of the other procedures and challenges that come up before an operator actually can get into business, which inhibitions of course, are not faced by foreigners who are serving the commerce of the United States and who can implement their decisions from day to day.

So, I really do not believe that doing away with trade routes is going to deprive the American shipper of service at all. It is probably going to enhance the ability to have service where there is a need.

Mr. TAVROW. Also, Senator, to add to that, I think that there is sometimes a potential of not paying full attention to what our defense establishment says when it says that we have a significant depletion of sealift capacity, particularly in times of emergency. And the public record is indeed replete with comments by senior military people in any number of circumstances saying there would be great difficulties in continuing, without very significant increases in the military budget, to maintain any kind of needed sealift capacity without a viable, innovative merchant marine.

And I clearly support what Mr. Amoss just said, that that really has very little to do with essential trade routes, that we will, as U.S.-flag operators, build and operate the ships that are needed for defense efforts if indeed we are given the legal and regulatory ability to do that for commercial purposes.

Senator INOUYE. In other words, from the standpoint of increasing and maintaining a viable ready reserve fleet, passage of this measure would be cost effective?

Mr. TAVROW. I certainly believe that.

Senator INOUYE. Under this bill, ODS operators may enter into space charter agreements with foreign flag operators. The present law prohibits an ODS operator from having foreign affiliations in trades where it would be competing with another U.S. operator, because the whole purpose of this program, the ODS program, is to enable our operators to compete with foreign carriers.

However, under this bill, if an ODS operator entered into a space charter agreement with a foreign flag operator, it would be cooperating with and not competing with the foreign flag carriers. What are your comments?

Mr. TAVROW. Senator, I think that it is important to understand that the way in which the liner operator industry is now and should be functioning in the future relative to the cost and the efficiencies of its operations. To use American President Lines as an example, we run highly cost-efficient, large, fast ships on the line haul runs. In other words, we are primarily a trans-Pacific carrier, and the trans-Pacific line haul ships hit the major ports, but it is not efficient to use those same large, expensive ships, to run to outports, to the smaller ports.

So, it is essential for the continued viability of a carrier like APL to be able to lift cargo destined for the United States from, or to take U.S. origin cargo to, those outports by serving those ports with smaller feeder vessels. We believe strongly that as a supplement and a support to the line haul ships, we should have the authority to be able to run smaller, foreign flag, cheaper ships to serve as feeder vessels.

This bill provides that authority, and we believe it is significant and important for our continued viability in the commercial marketplace.

Mr. AMOSS. Mr. Chairman, I want to comment on your question about operating in space charter arrangements and consortia, as it might be, because I think that is an important question to consider. In the deregulation that this bill provides, that would be an opportunity and a change that would be open to American flag subsidized operators.

I think we have to recognize two things. Consortia are a way of life in most of the rest of the shipping world in which groups, international groups, not just one flag or carrier, band together and put in a certain number of ships and operate a joint service with slot charter between one another.

This is a way of meeting the high capital requirements that a weekly service, for instance, imposes on a single operator, and it is a way of sharing shoreside facilities for the most efficient use of those facilities over and beyond the ships.

I think that when we limit the size of the American Merchant Marine, and yet we want to spread its influence all over the world, that the opportunity to participate in consortia, even international consortia, ought to be encouraged within the American Merchant Marine, and it will be, I assure you, the most efficient way to operate in high service requirement areas.

Mr. LOWMAN. Senator, the impact of your question was that using space charters was, in effect, cooperating with foreign carriers rather than competing. The fact is that an American carrier would not use a space charter for the purpose of cooperating. It would be an efficient way to handle, usually, a relatively short problem he has with reference to cargo. It could be extended, but generally it is not.

It is not a matter of cooperating. It is a matter of most effectively handling the particular assignment he has. If that space charter should grow and develop in a particular area, he might very well decide to put a ship over there, an American flagship.

Senator INOUYE. Under this bill?

Mr. LOWMAN. He would have the discretion to do whatever he wants.

Senator INOUYE. All operators would have that opportunity?

Mr. LOWMAN. Yes.

Senator INOUYE. My final question: Would this bill affect the foreign trade requirements of Hawaii or Alaska?

Mr. AMOSS. The foreign trade requirements? No, it would not. Carriers would be free to serve foreign to Hawaii, foreign to Alaska, just as they would be free to serve any port in the United States, and it would simply be a matter of the attraction of so doing.

Now, of course, on the domestic side that is well taken care of in the bill.

Senator INOUYE. On the other hand, under this so-called deregulation that you speak of, the operator need not serve Hawaii and Alaska from a foreign port.

Mr. AMOSS. Today, I do not believe there are any trade routes that require an operator to serve Hawaii or Alaska. There are options and privileges.

Senator INOUYE. Under ODS, are they not required?

Mr. AMOSS. No, sir, there is no trade route that has an absolute requirement for foreign to Hawaii, or foreign to Alaska, that I am aware of.

Mr. TAVROW. Senator, my reading of the bill is that it retains the same regulatory structure that exists in the Merchant Marine Act of 1936 relative to, as Mr. Amoss said, the domestic leg of the service to and from Alaska or Hawaii; that is, that it would require an ODS operator who receives ODS, obviously in the foreign commerce of the United States, to get approval to enter into the domestic market, subject to various grandfathering provisions that will be built into the law.

It does not, however, impact the foreign service to Hawaii and Alaska, which, in my reading of the bill, would be handled under this law by the marketplace. Those carriers who believe that it is appropriate in their trade routes to serve those two areas will either continue to do so as has been done in the past or will add them to their service as it will exist under the new law.

Senator INOUYE. Mr. Chairman, I thank you very much.

Senator STEVENS. Senator Gorton.

Senator GORTON. Thank you, Mr. Chairman. I have no questions.

Senator STEVENS. Thank you very much. We appreciate your courtesy, gentlemen.

[The following information was subsequently received for the record:]

COUNCIL OF AMERICAN-FLAG SHIP OPERATORS,
Washington, DC, November 17, 1986.

Mr. JOHN HARDY,
Professional Staff Member, Committee on Commerce, Science and Transportation, U.S. Senate, Dirksen Senate Office Building, Washington, DC.

DEAR JOHN: With apologies for the delay enclosed are answers to the questions submitted to both Panel 1 and Mr. Bru who was on Panel 2 following testimony on S. 2662.

Thank you for your reminder and we hope that these will be included in the hearing record.

Sincerely,

EDMUND T. SOMMER, Jr., *Counsel.*

Enclosure.

Question. This morning one of the smaller U.S.-flags (Waterman), which did not have an opportunity to participate in the drafting of S. 2662, will oppose several provisions in the bill, and suggest language to remove its objections.

I would hope that after the hearing you could meet with representatives of Waterman and make an accommodation.

Answer. Extensive meetings have been held between Waterman representatives and representatives of the other liner operators, including Sea-Land, since the July 24 hearing on S. 2662. Those operators proposed substantial concessions to Waterman which made Waterman the recipient of benefits available to no other entity. Waterman either declined, or never responded to, these various proposals. Attached [1] is a spread sheet which underscores the lengths to which these carriers have gone in order to accommodate Waterman's concerns. The left-hand side of the spread sheet is a Waterman advocacy paper. The right-hand side sets out the carriers' response and/or accommodation proposals. It should be stressed that the position of the carriers is that none of these proposals are final until everything is final, and Waterman no longer opposes S. 2662.

Question. In my view it is absolutely essential in the interest of national security and the welfare of our international water transportation system, that U.S. flag vessels be manned with U.S. merchant seamen.

[1] The attachment was not reproducible.

Given that requirement, don't we have to face the economic facts of life that the U.S. liner industry will always be faced with a competitive cost differential? In other words, we have to pay the price—"there are no free lunches."

Answer. Yes, and the situation is getting worse because our competition is less and less from OECD countries with relatively high standards of living and wages and more from less developed countries and state-owned fleets with low standards of living and lower wages.

Question. The Administration is, of course, trying to increase the size of our Ready Reserve Fleet (RRF), to be used in time of national emergency. If the present trend continues, however, and the number of actively employed U.S. merchant seamen decreases further, will there be sufficient personnel available to man the vessels in the RRF in time of national emergency?

Answer. Probably not. We understand a study is nearing completion by the Chief of Naval Operations' Strategic Sealift Division which concludes that within a very few years the ability to support mobilization operations could be seriously limited by the availability of active merchant mariners. We understand further that the study suggests four alternative concepts to solve the problem and concludes that the best solution would be a healthy and substantial commercial U.S. merchant fleet sufficient to support an active seafarer pool for emergency manning requirements.

Question. I note MARAD's Study *Reevaluation of U.S. Liner Trade Routes* was issued in September 1984; and the General References and Statistical Publications listed in the Bibliography for that Study are dated 1984 and before.

MARAD's Study is, of course, the basis for its proposal to redesignate essential trade routes.

In your judgment, has the situation in our liner trades changed materially in the time since MARAD's Study, so that some of the assumptions and conclusions in its need re-examining?

Answer. Conditions in many of our liner trades change from time to time. CASO member companies are continuously viewing the situation as it relates to MARAD's proposal and will provide their views on this to you, and to MARAD, as that proposal moves toward implementation. We hope that will be soon.

Question. Under S. 2662, once an operator is entitled to receive ODS, with one exception it can offer liner service anywhere at anytime in the foreign commerce of the United States.

In theory the opportunities of the marketplace would determine the trades that operators served, and the level of their service. We know, however, in the real world this is not the case, because some trades are heavily overtonnaged (e.g. Far East; North Atlantic).

Under S. 2662, therefore, would we run the risk of spending taxpayer dollars to subsidized competing operators which are not only economically unwise, but would have no public interest justification?

Answer. Under any system there will always be less than optimal distribution of resources. However, as deregulation of domestic transportation modes has generally shown, distribution is best when left to the marketplace. We believe that this fundamental precept of a free economy will also result in the best possible distribution of U.S. flag liner services under the provisions of S. 2662.

Question. Under present law, ODS is available to maintain adequate service on trade routes essential to the foreign commerce of the United States.

Not all trade routes essential to the foreign commerce of the United States are necessarily economically attractive to U.S. operators (e.g. Australia). Nevertheless, the law does offer some incentive to U.S. operators (ODS).

Under S. 2662, however, there would be no ODS incentive, because service on an essential trade route would no longer be a condition of ODS. Is that correct?

Answer. It is true that under S. 2662 a carrier would not be legally required to provide service on any particular route. That, of course, is one of the main elements of the legislation. Carriers should not be tied to specified trades if those trades are not profitable. Carriers should be encouraged to seek and develop commercially rewarding trades and services. ODS is and always has been a wage-differential designed to place U.S. vessel operators, employing U.S. citizen seamen, on relative parity with their foreign competition. It is not an "incentive" to serve any given route.

Question. Present law (Sec. 809(a)) requires that ODS contracts be entered into "so as to equitably serve, insofar as possible, the foreign trade requirements of the Atlantic Gulf, Great Lakes, and Pacific ports of the United States."

Would this requirement remain under S. 2662?

If not, would there be any assurance under S. 2662 that the "foreign trade requirements of the Atlantic Gulf, Great Lakes, and Pacific ports of the United States would be equitably served"?

Answer. The requirement cited would not longer remain under S. 2662. However, experience shows that this requirement has not been particularly effective in ensuring equitable service particularly since the development of intermodalism. This is understandable particularly if one remembers that ODS is designed simply to put the U.S. flag operator on a wage cost parity with his foreign competitors and does not offer economic incentives to provide service to U.S. ports where it is otherwise uneconomic to do so.

Question. Under present law (Sec. 801) financial records of ODS recipients are to be kept in accordance with DOT's regulations, and the Secretary of DOT has a right to examine the books, etc.

Does S. 2662 give the Secretary the same rights with respect to operators who would be entitled to enter into contracts or amend their existing contracts?

The Secretary would still have this authority over operators who choose not to amend their existing contracts. Why should S. 2662 treat the two classes of ODS recipients differently in this respect?

Shouldn't the Secretary have the right to examine an ODS recipient's financial records inasmuch as government funds are involved?

Answer. We agree that the Secretary of Transportation should have the right of reasonable examination of the financial records of all ODS recipients.

Question. Under S. 2662 would you receive less subsidy per ship than you are currently receiving under your ODS contracts?

Answer. Yes.

Question. According to MARAD statistics, U.S.-flag liner subsidized operators carried only 11 percent of the cargo in the U.S. foreign commerce. Unsubsidized U.S. operators carried 10 percent and foreign-flag competitors carried *79* percent.

Under S. 2662 ODS operators would be free to compete in all of our foreign trades.

Would this lead to a situation where U.S. tax $ (ODS) would be used to subsidize competition between U.S. operators? In other words, in the real world would the result be that more U.S. subsidized operators would be competing for the present 21% of the cargo carried by U.S.-flags?

Answer. No. The primary effect of the system contemplated by S. 2662 would be to place all U.S. flag liner carriers in a better position to compete with the foreign companies for all of our international liner trade.

WATERMAN STEAMSHIP CORP.,
New York, NY, December 19, 1986.

Hon. DANIEL K. INOUYE,
U.S. Senator,
Hart Building, Washington, DC.

DEAR SENATOR INOUYE: We have reviewed the questions submitted by you to "Panel 1" at the conclusion of the hearing on July 24, 1986 on S-2662 and have studied their answers. We particularly note the answer to question no. 1 on page 1 and the "spreadsheet" which it references and take this opportunity to comment.

The answer to question 1 does not accurately represent the course of discussions between Waterman Steamship Corporation and other U.S.-flag operators. The "spreadsheet" is based on a Waterman point paper which became obsolete as a result of those discussions, since various of the points made therein were clarified either in subsequent discussions or suggested redrafts of legislative language.

The dialogue between Waterman and the other operators continued until near the close of the 99th Congress, with numerous presentations of suggested amendments by Waterman at meetings thereon which were attended by various of the other operators. The early response of Waterman to provisions of S-2662 included in the "spreadsheet" became obsolete several times over in light of subsequent developments.

Brief comments on the substance of the statements made by "Panel 1" and Mr. Bru of United States Lines as to discussions with Waterman should clarify the record. Waterman does not hold the view that the 1936 Act's program of parity has been a "failure." However, in the present warped supply/demand situation in most commercial trades, parity (even true parity) is not enough to carry the U.S.-flag lines through the resulting rate depression. The problems of U.S. and foreign-flag operators alike have been brought on by worldwide over-tonnaging caused by overly

"easy money" for new buildings and ill-advised expansionist national policies regarding shipping and shipbuilding.

The 1936 Act program is no more than a convenient "whipping boy" for those who cannot face the reality that the only solution to industry problems is a national policy to bring supply and demand into better balance so that rates which are causing industry-wide losses will tend toward compensatory levels. As recent history has shown, the interested parties are deluding themselves in thinking that more new ships, no matter how "efficient," can overcome the problem caused by the supply/demand imbalance. The government policies responsible for this situation can only be changed by intergovernmental action (see report of the United States Conference and Trade and Development secretariat). Attached is a copy of excerpts from the conclusions and recommendations section of that report, which is entitled "Major Issues In World Shipping," subtitled "Merchant Fleet Development," 25 August 1986, TD/C/C.4/301. The parity concept of the 1936 Act was and is valid, but the policies of that Act which regulated supply/demand in the U.S.-flag services were also valid.

Waterman's experience is an instructive case history. When extreme over-tonnaging hit the Persian Gulf trade, Waterman sustained heavy losses and was forced to take tonnage off the route and withdraw from that service. In the Indian subcontinent commercial and reserved cargo markets, there is at the present time more of a supply/demand balance and rates have remained in a compensatory range, except on those commodities which were subject to United States Lines' ill-advised competition with its "deregulated" Econship service. Until now, the preference trade in the Indian subcontinent market has not fallen victim to destructive direct rate competition but if it does, rates will fall below compensatory levels.

The U.S.-flag industry is the victim of the lack of any regulating mechanism of supply/demand in world shipping. What stabilizing effect conferences had was eliminated by the Shipping Act of 1984, which effectively abolished dual-rate systems, necessary self-policing and the tariff rate system. The 1984 Act has been a disaster for U.S. *ocean* carriers, and has only benefited interests whose motivation is to achieve lower rates at the expense of losses to the ocean carriers or to buy market share from existing carriers with rates below costs, resulting in tremendous losses.

The concept of the immediate, additional entry of foreign-built ships into the last trades where there are barely compensatory rates is an act of desperation which Waterman cannot support. The hope of magical salvation in a new program where the demand/supply imbalance is made *worse* by the addition of new tonnage is a snare and a delusion. The unfettered introduction of foreign-built ships into neighboring preference trades would make "trade route protection" a mockery for Waterman, since the radically lower rates resulting from such overtonnaging would impact on Trade Route 18. The same companies whose testimony supported a new subsidy program without rationalization are now in deep financial difficulties, an experience which Waterman already has extracted itself from and from which it learned, painfully.

The current experiences of various U.S.-flag operators underscore the Waterman position throughout the "SWAP/ODS" recent discussion, which was the paper concessions, such as regarding the number of ships to be built, are meaningless if there is to be unbridled over-tonnaging of the preference trades and no attempt to work toward a solution of the underlying problems. Waterman cannot be party to such folly, which is even more ill-advised than the emasculation of the conference system and the tariff rate system.

The same blind rush to destruction is evident in the desire to pass an instant deregulated, non-parity based program as was the case with the deregulatory fever behind the 1984 Act. The one benefit of the 1984 Act, the enhanced ability of U.S.-flag operators to rationalize services with other U.S. operators, has not been used by the industry. One witness at the hearing on S. 2662 was not even aware that it was lawful for U.S.-flag operators to make such agreements, which are actually *required* by ODS contracts.

Thus, Waterman's major concern was not addressed by the other operators who insisted on the elimination of protections against unsubsidized ("G.O. 80") and foreign-built (the "3 year rule") competition, to their detriment as well as Waterman's. Waterman will support a sensible, well-thought-out program, but not one which carries the certainty of further internecine destruction.

The major problem with the "concessions" or "benefits" which are now discussed as if they were firm, binding commitments, is that they were not binding on all interested parties. Waterman believed that the ostensible agreement by various of the other interested parties was more cosmetic than real. This was confirmed by the

express statement of APL's representative that there was no commitment to support these concessions in conference. It seemed apparent to Waterman that the absence of at least one key interested party and the refusal of others to commit to support of "concessions" through the legislative process rendered the "concessions" illusory. Waterman's concern with this aspect of the negotiations was evidenced by the attached cover page which accompanied amendments suggested by Waterman at a late stage of the discussions.

In sum, it was and is Waterman's belief that the informal commitments of various operators on points made by Waterman did not constitute a meaningful commitment which would carry through the legislative process. To the extent the industry can agree on provisions which would solve the problems raised by various interested parties, there must be complete agreement among all interested parties and a sincere commitment to see those provisions through to passage by both houses of congress.

Sincerely,

GEORGE H. HEARN,
Executive Vice President.

Attachments.[1]

[ATTACHMENT]

AMENDMENTS TO SEPTEMBER 22, 1986 REDRAFT OF S. 2662

These provisions are presented by Waterman with the understanding that all the supporters of S. 2662, as revised, will support these provisions until completion of the legislative process.

Senator STEVENS. Our next panel is Mr. Abely, Chairman and chief executive officer of Sea-Land; Mr. Bru, chairman and chief executive officer of United States Lines; and Mr. Frank Drozak, president, Seafarers International Union.

Good morning, gentlemen. My schedule shows Mr. Abely first. We will be pleased to proceed as you wish, but I think it would be good to just go right on down the list.

STATEMENTS OF JOSEPH F. ABELY, JR., CHAIRMAN AND CHIEF EXECUTIVE OFFICER, SEA-LAND SERVICE, INC.; WILLIAM B. BRU, CHAIRMAN AND CHIEF EXECUTIVE OFFICER, UNITED STATES LINES, INC.; AND FRANK DROZAK, PRESIDENT, SEAFARERS INTERNATIONAL UNION OF NORTH AMERICA, AFL-CIO

Mr. ABELY. Thank you, Mr. Chairman. I am Joe Abely, and I work for Sea-Land Corporation. I, too, wish to thank the committee for the opportunity to appear today.

In particular I would like to express, I think, all of our appreciation for the support that both Senators Stevens and Inouye have given to the industry through what has been a long and arduous 18 months as we have worked together and, I think it would be fair to say, struggled together to bring forward a bill that would represent as much harmony and as much mutuality of interest as could be found between the companies and the maritime union interests.

I think that the bill that is before you today is representative of that effort. It is supported by companies which own and operate some 90 percent of the liner vessels that are operating in the U.S. foreign commerce which, of course, is the area in which S. 2662 is proposed to legislate. It is supported, we think, by and large by the maritime unions, and we will, of course, hear more about that today.

I think that it is important, again, to realize that the legislation that has now come forward is the product of a very strenuous effort in which all of the interests had to recognize that it was a give as well as a take exercise, and that in the end the legislation does represent a number of tradeoffs in the interests of the various parties that have come before you today to support the bill.

It seems to me that the essence of the bill, and I will not summarize it or describe it in detail because I think Mr. Tavrow did that to perfection in his statement, is to compromise the needs for the presently subsidized/regulated carriers for greater freedom of action in plying the foreign commerce trade lanes and the needs for the presently nonsubsidized companies to participate fairly and equitably in the government's promotional program.

I think it is important that we keep in mind this tradeoff as we address the second subject of today's hearing, and that is the regulatory proposals regarding General Order 80 and dissolution, I would call it, of the essential trade route system.

Here again, I will be brief because our statement dwells on this aspect in some detail, but first we have said that we believe that revocation of General Order 80 and dissolution of the esssential trade route system really usurps a legislative prerogative. These two subjects go, we believe, to the heart of the 1936 act. They go to the heart of the obligations that have been undertaken for the receipt of subsidy, and they go to the heart of the legislative objective of effectively encouraging, first, the nonsubsidized operation and, only secondly, subsidized operation.

Secondly, we believe that revocation of these two cornerstones of present policy in the absence of a broader legislative policy that would be considered and approved by the Congress would probably work to the advantage of two or three carriers but clearly would work to the disadvantage of the remainder, and not just to the presently nonsubsidized operators.

Finally, we also believe that this type of legislative action on the part of the Maritime Administration will not serve the interest of advancing an overall legislative solution. It will, by adopting a piecemeal approach to a very hard-worked compromise between the companies, in our judgment discourage rather than encourage a full legislative solution with a full policy support behind it.

Now, Mr. Chairman, I think that I will leave my remarks at that in order to preserve more time for your and Senator Inouye's questions. Thank you.

[The statement follows:]

STATEMENT OF JOSEPH F. ABELY, JR., CHAIRMAN AND CHIEF EXECUTIVE OFFICER, SEA-LAND CORP.

Mr. Chairman, Members of the Subcommittee, I am Joseph F. Abely, Jr., Chairman and Chief Executive Officer of Sea-Land Corporation. Thank you for this opportunity to provide the views of Sea-Land Corporation and its subsidiary Sea-Land Service, Inc. on the far reaching issues currently before you.

After eighteen months of discussion, the three largest subsidized liner companies and Sea-Land are in support of S. 2662, a bill to reform the Operating Differential Subsidy program for liner carriers. Achieving this commonality of view required a great deal of give and take and might not have been accomplished without the firm support and encouragement of this Subcommittee's leadership.

The four largest American-flag liner companies agree that S. 2662 provides an equitable and fair system of government promotion for all qualified U.S. liner carriers, rather than the current program for only six companies. We expect that other currently non-subsidized lines will also find the proposal beneficial.

It is unfortunate, at this time, that the Maritime Administration contemplates promulgating rules which are directly in conflict with legislative reform of the subsidy program. In my comments today, with your permission, I shall first discuss the proposed regulation changes and then S. 2662. But under no circumstances should my remarks be deemed to in any way evidence lack of support for S. 2662.

Our principal operating unit, Sea-Land Service, Inc., operates a fleet of 56 containerships, of which 30 are registered in the U.S., and over 100,000 containers in the U.S. domestic and foreign commerce. Sea-Land vessels call at 76 ports and serve 64 countries and territories around the globe.

I believe you are aware that Sea-Land, which pioneered oceanborne and intermodal container shipping 30 years ago, has never participated in the operating-differential subsidy ("ODS") program. But Sea-Land and the other U.S. non-subsidized liner operators have been very cognizant of, and adversely affected by, the ODS program for years. Sea-Land competes directly with the six liner operators who collectively receive about $280 million in ODS annually.

In our view, there are two interrelated issues before you: Should the Maritime Administration be allowed to implement its pending proposals to abolish the existing Essential Trade Route system and the existing regulation of ODS operators' non-contract vessel operations? If not, why not? Should Congress seize this opportunity to legislatively restructure and reform the liner ODS program? If so, why; and what form should the restructuring and reformation take?

For three fundamental reasons, our view is that the answer to the first question is an emphatic "No".

First, the pending MarAd actions constitute a gross usurpation of Congress' power to legislate. All would agree, I believe, that the pending MarAd actions would effect radical changes in fundamental rules which have governed the ODS program since its inception in 1936. Such a characterization is true as far as it goes, but it does not go far enough. For the fact is that the regulatory changes proposed would be so radical, and the rules involved are so fundamental, that the pending actions involve nothing short of de facto amendment of the Merchant Marine Act of 1936 with seriously adverse consequences for most of the U.S. liner companies.

Turning, first, to the trade route redesignation proposal, the provision of the 1936 Act involved is §211, which directs MarAd to determine the "ocean services, routes and lines from ports in the United States . . . to foreign markets which are . . . essential". Pursuant to that direction, MarAd has over the years developed a system of 27 Essential Trade Routes between one or more U.S. coasts and specified foreign port ranges.

The major importance of the designations made under §211 is, of course, that ODS awards are predicated on need for service on particular routes, and thus each subsidized operator is required to provide subsidized service on the essential route or routes specified in its contract and no others. It is evident that the current Essential Trade Route system is fully in accord with the terms of §211, as well as with Congress' intent in enacting that statute as revealed by its legislative history.

Yet MarAd now proposes to sweep away this longstanding Essential Trade Route system, and to replace it with a system that divides the entire world into eight extremely broad "trade areas". This proposal would render the statutory language of §211—which clearly contemplates specific designations—a complete nullity. I should add that MarAd apparently perceives no limit to how far it can go in dismantling the trade route system. The so-called study done by the agency on the matter indicates that the eight trade area concept might be only an interim step, with the ultimate objective being a system that divides the entire world into three far broader trade areas. By MarAd's interpretation of the statute, it apparently would be permissible for MarAd to designate just one trade area—between the United States and everywhere else in the world.

MarAd's proposal to revoke General Order 80 and end all controls on non-subsidized operations by subsidized operators, again, would completely reverse a course which has been consistently followed since the inception of the Act. MarAd initially controlled non-contract operations through ODS contract provisions alone, but subsequently, in 1957, General Order 80 was issued for this purpose.

The critical point to be made here is this: Congress has been fully aware of the long history of MarAd control over non-contract operations, and on only one occasion has Congress ever enacted an exemption from it. That exemption is the very limited one contained in the Snyder Amendment, §614 of the Act. Section 614—enacted only a few years ago—allows a subsidized operator to operate certain vessels free from most statutory and contractual restraints, but only if a number of requirements are met. These include requirements that the vessels involved be contract vessels as to which the operator has suspended its contract, that the vessels be less than ten years old, and that the suspension period, during which the vessel would be operated without any subsidy, be not less than twelve months. Thus the Snyder Amendment offers subsidized operators a trade-off: greater freedom to operate non-contract vessels in exchange for receiving less subsidy under their contracts. This statutory approach fosters more even-handed competition between U.S.-flag carriers and reduces government expenditures.

MarAd's proposal to revoke General Order 80 would lead to a much different result. It amounts to an effort by the agency to override the Snyder Amendment with a blanket waiver for all vessels owned or operated by a subsidized operator. It would

permit non-contract operations without any limitations whatsoever, regardless of vessel age or length of time. Moreover, because the MarAd proposal applies to any vessels owned or operated by a subsidized operator, there would be an incentive to conduct non-contract operations with additional vessels that are not now part of the operator's contract. Thus the trade-off aspect of the Snyder Amendment would be largely, if not entirely, nullified and the negative impact on non-subsidized carriers increased.

To summarize, the pending MarAd actions seriously infringe on Congress' rightful powers and should not be allowed to be implemented. Recently the Supreme Court struck down a Congressional enactment which, according to the Court, improperly involved Congress in the execution of laws. Congress should just as surely preclude these efforts of the Executive Branch to improperly usurp Congress' power to legislate.

The second reason why Congress should prohibit the pending MarAd actions is that they would be highly unfair and extremely detrimental to Sea-Land and other unsubsidized U.S.-flag operators, as well as to the smaller subsidized operators. In other words, the actions would harm most U.S. liner carriers to benefit only three. In proposing to abolish the Trade Route system and controls on non-contract operations, MarAd has entirely ignored the reasons why those regulations were issued in the first place. Yet these reasons are just as valid today, and will be so long as the existing ODS program stands. Chief among those reasons is to afford some protection to unsubsidized U.S.-flag operators: protection which is entirely necessary in view of the obvious and significant competitive advantage that ODS confers upon the subsidized operators.

The MarAd proposals would strip away by administrative fiat much of the necessary limits on subsidized U.S.-flag operators. They would go a long way toward permitting subsidized operators to operate exactly like their unsubsidized competitors. But at the same time, the subsidized operators would be permitted to retain the considerable competitive advantage of subsidy. Moreover, under the existing ODS program, it is impossible for the currently unsubsidized operators to eliminate this serious inequity by becoming subsidized operators themselves. This Administration took a unilateral position not to enter into any new ODS contracts under the existing program. This was done without amendment to the statutory requirements of the 1936 Act and compounds the competitive threat for unsubsidized carriers.

Specific ways in which the pending MarAd actions would cause serious competitive injury to Sea-Land and other operators were spelled out in detail in filings that were made with MarAd. I won't repeat that detail here. With regard to the injury to Sea-Land, however, I can sum up the key points quite briefly. Implementation of either proposal would inevitably result in redeployment of subsidized operator's vessels—subsidized and/or unsubsidized, as the case may be—into the major East-West trades—U.S. Atlantic-Europe and the U.S. Pacific-Far East trades. These are the two major trades which Sea-Land serves, and the prevailing vessel utilization and depressed rate levels establish that thos? trades are already overtonnaged.

Yet more and more capacity of the subsidized operators would undoubtedly be placed in those trades if the MarAd proposals were implemented, primarily because they are both high volume trades in which generally high value commodities move. In addition, the ports and inland transportation infrastructure of those trades are compatiblle with technologically advanced vessels. It is no exaggeration to state that with the capacity increase in those trades which would likely result from implementation of the two MarAd proposals, vessel utilization and rate levels would sink to disastrously low levels.

I should also note that the currently unsubsidized operators are not the only ones which would be injured by the pending MarAd actions. The three smaller of the six subsidized operators protested both of the MarAd proposals vociferously. Ironically, S. 2662, supported by Sea-Land and the three larger of the six subsidized operators, recognizes the need for legislation to eliminate both Essential Trade Route service requirements and regulation of non-contract vessel operations in the context of a new and equitable subsidy system, but also includes specific trade route protection for the smaller subsidized operators: whereas the two MarAd proposals include no such considerations.

I must candidly state that it is not clear whether MarAd is irrevocably committed to the proposed rule changes, or is using them as a threat to encourage thorough legisla-

tive reform. The agency appears to be absolutely committed to implementing these proposals exactly as made, without any significant alteration, in the immediate future. The facts strongly indicate that the only thing that will stop the agency is the enactment by Congress of specific legislation to confirm Congressional intent.

The third reason why Congress should prohibit the pending MarAd actions is a pragmatic one, and one that is directly related to the other subject on which I will speak: The compelling need for comprehensive legislative reform of the ODS program for liner carriers. Implementation of the MarAd regulatory proposals would clearly undermine the larger subsidized operators' motivation to support such legislation.

The legislative proposal which the three larger subsidized operators and Sea-Land support in effect offers all of us a balanced trade-off. In exchange for eventual elimination of non-wage ODS and broadening the program to include presently non-subsidized U.S.-flag liner competitors, currently subsidized operators would be granted, among other things, release from four major restrictions of the current program: (1) the requirement that subsidized services be confined to particular Essential Trade Routes, (2) the restrictions on non-contract operations, (3) the requirement that subsidized vessels be U.S.-built, and (4) the restrictions on the use of foreign-flag vessels as feeder vessels.

The pending MarAd actions would grant the larger subsidized operators the first two of these four major benefits of the legislation without providing any balanced trade-off at all. Having secured those benefits without giving up anything, would subsidized carriers then support comprehensive legislation? Not likely. The chances that comprehensive ODS reform legislation could be enacted without the support of those subsidized operators are, at best, greatly reduced.

The pertinent facts establish beyond doubt that the existing liner ODS system has failed, is badly outdated, and is in dire need of comprehensive legislative reform. Most generally, after the payment of over $7 billion under the current program to about 25 subsidized liner operators over the years, only five of them remain in operation today.

As to the performance of the total U.S.-flag liner fleet in carrying U.S. foreign commerce cargoes, MarAd statistics show that in 1985 they carried less than 21 percent of the liner cargo, with the subsidized liner operators carrying only 11 percent of the liner cargo. That was the worst performance recorded since MarAd began keeping these statistics in 1956.

In addition, according to MarAd data, the amount of subsidy paid to liner ODS operators per ton of cargo carried has gone up dramatically since 1969. By 1984, that figure had reached $41.25 per ton. This means that in many instances, the Government, under the current ODS system, is now paying more ODS per ton of cargo than the freight charge that the shippers themselves are paying to move that cargo! Average ODS per subsidized liner vessel per ship year has also risen dramatically. MarAd's Fiscal Year 1987 projection for the current program averages $3.77 million per ship year, which is 500 percent higher than the same statistic for 1969.

Quite clearly, the only cure for the ills evidenced by these numbers is comprehensive legislative reform. Mere piecemeal, patchwork mending by administrative rulemaking assuredly will not do the job. That approach created the current situation and would only worsen the current subsidized-unsubsidized inequities.

Just as Congress clearly should not countenance the Maritime Administration's widening the inequity of the existing, failed ODS liner program, Congress equally clearly ought not allow that program to continue in status quo. Rather, the opportunity to legislatively restructure and reform that program should be seized.

What criteria should be used to restructure and reform that program? It has been Sea-Land's position that the program should be revised to create a system more: equal and equitable in terms of access, eligibility, prompt availability and duties as among all qualified American liner operators; competitively effective in terms of unleashing U.S. liner operators so they may vie for the market with their foreign-flag counterparts with comparable flexibility; and cost effective, in terms of both ODS cost/benefit ratios and Congressional control of, and oversight over, the program's continuing costs.

S. 2662 meets those criteria.

As regards equality, availability of the program to currently subsidized and non-subsidized operators alike commences 30 days after enactment (Sections 621(a) and 622(a)).

Citizenship requirements aside, the only condition precedent to the applicant's right to a contract is that it have operated U.S.-flag liner vessels in our foreign commerce for a continuous one-year period prior to date of enactment (Section 617(a)). Subsequent entrants need only meet this same one-year service condition before applying for a contract, with approval at the discretion of the Secretary and with no right to oppose contract award provided to other operators or applicants (Section 617(b)). All new contracts and existing ODS liner contracts amended to take advantage of the new program would expire concurrently ten years after enactment. The Secretary would have the right to renew such contracts for additional periods not in excess of ten years (Section 620(1)). This uniform sunset provision will give the Executive Branch and Congress an opportunity to reassess the program in its entirety at a not too distant point in time.

S. 2662 also provides for parity in terms of scope of subsidy. That is, the basic focus of the subsidy to be paid under the new program is the difference between American seamen's wages and foreign seamen's wages (Section 625(6)). While Section 618(b) provides for the payment of non-wage subsidy for two years after enactment to the extent that such subsidy is payable under the current contracts for existing subsidized operators who amend their contracts, and while Sec. 5 authorizes capital infusions to small existing subsidized operators who amend their contracts; over 97% of Government support to the liner industry would be for wage-differential offset. Sea-Land and other currently unsubsidized lines would receive no non-wage subsidy.

As the quid pro quo for all liner carriers to participate in the new program, they will have the same duties and responsibilities to the Government. All will ultimately be limited to the use of U.S.-flag vessels crewed by American seamen in operations between the United States and foreign countries (Section 620(b) and (j)). All will be required to make their vessels available to the U.S. Government in time of national emergency (Section 620(k)). With certain limited exceptions, a subsidized operator will be precluded from providing service in the domestic trades without a full hearing (Sections 620(c) and (n)) and from operating foreign vessels or having foreign affiliations in competition with U.S. operators without the requisite waiver (Section 620(b) and SEC. 4(3)).

As regards competitive effectiveness, S. 2662 contains a series of provisions which would strengthen the ability of the entire U.S.-flag liner fleet to compete efficiently against foreign-flag carriers without the restrictions now necessary to shield U.S.-flag non-subsidized operators from unfair competition.

The four most important of those provisions are:

1. Subsidized Foreign-Built Vessels. Liner vessels qualified to be subsidized under the new program may be U.S. or foreign-built (Section 625 (1) and (2)), but must be registered in the U.S. and employ U.S. officers and crew. This provision in and of itself will result in a significantly lower cost base and reduced operating (including manning) expenses inherent in automated, diesel vessels. Replacement of currently obsolete U.S.-flag tonnage with modern, low cost vessels will go a long way toward making the U.S.-flag liner fleet competitive with its foreign-flag counterparts.

2. Essential Trade Routs. section 4(2) provides for limited trade route protection to existing small subsidized operators who do not opt to participate in the new program. section 620(a) would otherwise eliminate Essential Trade Route service requirements providing subsidized liner operators with the ability to adjust their service levels and scope in response to changing market patterns.

3. Additional Unsubsidized Service. While section 623(a) of S. 2662 sets out balanced limitations on the number of subsidizable ship years contractors may perform, section 620(a) of the bill provides that contractors are not to be precluded from operating additional U.S.-flag vessels on an unsubsidized basis anywhere in the international trade they so choose, except for the limited small subsidized carrier trade route protection provisions noted just above.

4. Foreign-Flag Feeders. SEC. 4(3) of S. 2662 authorizes contractors under the new program to operate, without prior approval, up to twice as many foreign-flag feeder vessels as the number of the contractors' U.S.-flag contract vessels operating under ODS. These feeder vessels significantly enhance the productivity potential of the U.S.-registered linehaul vessels.

In combination, these four pro-competitive program revisions will give the operators the opportunity to both reduce costs and enhance revenue through:

Upgrading their fleets with lower cost, more productive and more operating cost efficient liner vessels.

Making more annual sailings through calling a lesser number of foreign linehaul ports; using foreign-flag feeder vessels to collect and distribute cargo at secondary foreign ports.

Greater vessel utilization by dint of the flexibility to adjust service levels and scope responsive to changing market patterns and through use of foreign-flag feeders to reach additional markets.

If equally available to all U.S.-flag liner operators, these benefits will also further the purposes of the 1936 Act. An evenhandedly supported American liner fleet will have both the capacity and capability to increase the American-flag effective presence and market share in U.S. foreign commerce and international trade.

As regards cost effectiveness, S. 2662 clearly will result in cost/benefit ratios superior to those which have been experienced under the current program. This is not to say that the new program will result in less total subsidy outlay than the current program. Preliminary estimates are that—assuming all qualified operators take full advantage of the program the liner subsidy costs to the United States would average about $350 million in current dollars during the first three years after enactment, leveling off at approximately $300 million in current dollars for the last five years of the new program. Putting these amounts in historical context, they are $55 million and then $5 million greater than the $295 million average ODS liner accruals in fiscal years 1981 through 1985 inclusive.

It is important to recognize that our preliminary estimates of future ODS liner accruals under the new program are premised on all qualified operators (except Waterman, which is assumed to stay on its existing contract) taking full and immediate advantage of it. That is highly unlikely. An analysis prepared in April for Sea-Land by Manalytics, Inc. projected, among other things, the costs of H.R. 4582, which provided for a 25 ship year cap as compared to the 23 ship year cap in S. 2662. Taking into account historic levels of ODS liner contract authority implementation and future capacity/cargo ratios, Manalytics' judgment was that only 75% of full subsidizable liner service potential by all participants would be availed of under H.R. 4582. If as seems prudent—it is assumed that no more than 85% of the full potential subsidizable ship years provided for in S. 2662 is availed of, future annual liner ODS subsidy levels will be about the same as those experienced in recent years.

The subsidy projections noted above assume up to 124 subsidized U.S.-flag liner vessels in operation by fiscal year 1988, while the Maritime Administration projects only 72.5 ship years of subsidized liner vessel operation in fiscal 1987 under the present program. Under the new program, it can be expected that by fiscal year 1989 over half of the 124 vessels in the U.S.-flag subsidized liner fleet will be comprised of competitive, automated diesel vessels. That fleet will have the capability to substantially increase U.S.-flag commercial liner cargo participation and to significantly lower the amount of ODS paid per ton of liner cargo carried.

But the most telling cost/benefit comparison involves what the state of the U.S.-flag liner industry will be ten years from now under the new program as opposed to aggravating the present inequities in the program with ruinous consequences to the fleet. Under the new program, we project a 1996 operating liner fleet of up to 124 modern, competitive vessels. Without legislation, there would then be about 42 subsidized liner vessels left in service. If for national security purposes the resulting naval support vacuum were filled by added inactive vessels in the Ready Reserve Fleet, hundreds of millions of dollars of supposedly "saved" liner ODS would be exceeded by far larger costs in the Department of Defense budget for a "standby sealift" capability, both ships and personnel. Meanwhile, U.S.-flag liner cargo participation would fall to the single digit levels currently being experienced in the non-liner segment. As added liner vessels leave the active U.S. fleet, federal costs for transport of government-impelled cargoes could increase dramatically.

The first time that the principal officers of Sea-Land and the three largest subsidized liner operators met to discuss comprehensive liner subsidy reform legislation in January, 1985, they agreed upon the following set of principles.

"Seeking legislation that will recognize the liner industry as an industry in its own right rather than a segment of the broader maritime industry.

That will provide the broadest possible freedom of action for all members—i.e. deregulation—.

Jones Act continues as is.

That treats all members in the same fashion—i.e. puts all on an equal footing vis-a-vis each other as competitors and in their relationships with the Government in the legislative and regulatory arenas.

Within this framework We believe that the liner industry will always be faced with a competitive cost-differential in fulfilling its obligation to man its U.S.-flag vessels with U.S. merchant seamen.

We believe that it is a clear requirement for the maintenance of a defense-capable merchant marine that U.S. merchant seamen continue to maintain their capability thru operation on the water.

We believe that it is in the national interest that the U.S. Government provide support to the maritime effort which reimburses this necessary competitive cost differential."

S. 2662 is consistent with these principals. Accordingly, we urge its favorable consideration by this Subcommittee, and offer to cooperate with you in furtherance of enactment in the short period of time remaining.

Again, thank you for this opportunity. We will be glad to try to answer any questions or provide further information.

[The following information was subsequently received for the record:]

QUESTIONS OF SENATOR INOUYE AND THE ANSWERS

Question 1. a. The trade route between the East Coast of the United States and the Mediterranean is an Essential Trade Route, is it not?

Answer. Yes it is.

b. Doesn't that trade contemplate service in both directions so that both United States shippers and consignees will have U.S.-flag service available to them?

Answer. Yes it does.

c. Don't Farrell and Prudential both operate round subsidized voyages in those trades?

Answer. Farrell does. Prudential did until recently.

d. Over the years hasn't the United States paid those two companies collectively over a billion dollars in ODS?

Answer. Yes. $1.3 billion as of Fiscal Year 1984.

e. Doesn't U.S. Lines (USL) unsubsidized Round-the-World service now carry cargo from the United States to a French port (Fos) on that trade route, but not any return cargo?

Answer. To the best of our knowledge, that is correct.

f. And then doesn't USL redistribute the cargo in the Mediterranean with foreign-flag feeder ships?

Answer. Yes.

g. But Farrell and Prudential can't use foreign-flag feeder ships in the Mediterranean, can they?

Answer. Not without a waiver by MarAd of the prohibition contained in Section 804.

h. Isn't USL a subsidized operator on other trade routes collecting on a company wide basis much more subsidy than either Farrell or Prudential?

Answer. In the current fiscal year, that is correct.

i. Support that in this one direction USL service will cause severe economic injury to Farrell's ability to provide this Essential round service. Under these circumstances I have just outlined, don't you think that there is a reasonable basis for that assertion by Farrell?

Answer. Yes.

j. But if General Order 80 did not exist, Farrell would have no recourse to MarAd to ask that USL's one-way service on that route be regulated would it?

Answer. That is MarAd's view. In Sea-Land's view, MarAd's current duty in that regard exists in the current law whether or not General Order 80 is repealed. However, General Order 80 serves a useful purpose in providing objective standards as opposed to the need, in its absence, for ad hoc determinations.

Question 2. a. Currently, doesn't General Order 80 apply if, for example, a subsidized operator between the U.S. Gulf Coast and the Far East wanted to deviate off of its route and call the West Coast of the United States?

Answer. Yes.

b. Under such circumstances, is it correct that the subsidized operator would lose some fraction of the ODS otherwise payable for the time he deviates from his normal itinerary to make the off route call?

Answer. Yes.

c. If so, doesn't the subsidized operator end up collecting only 80 or 90 percent of the ODS otherwise payable rather than full ODS?

Answer. Yes.

d. If General Order 80 is abolished, couldn't an operator do this without getting any permission from MarAd or concurrence from an unsubsidized operator serving between the West Coast and the Far East?

Answer. That is MarAd's view.

e. In those circumstances, isn't the subsidized operator in reality being subsidized for the entire sailing, but at a proportionally reduced amount?

Answer. Yes.

f. Wouldn't that ODS constitute a competitive advantage to the ODS operator in comparison to an unsubsidized operator's service between the West Coast and the Far East?

Answer. Yes.

g. And yet, if General Order 80 is abolished, that unsubsidized operator would have no opportunity to attempt to prove to MarAd that there was already sufficient U.S.-flag service and that he would be competitively impacted by the subsidized operator deviating off of his trade route to compete with the unsubsidized operator on his trade routes?

Answer. That is correct, unless MarAd on its own or as a result of judicial direction recognizes its statutory responsibility even absent General Order 80.

Question. MarAd has two rulemakings pending:

Repeal General Order 80.

Redesignate the 27 Essential Trade Routes into 8 Trade Areas.

The Administrator has requested legislation to:

Permit ODS operators to build foreign.

If these three proposals went into effect would you still want the legislation you are supporting here?

Answer. To the extent that Sea-Land continued to operate as a U.S.-flag operator, Sea-Land would still want the legislation. However, the current subsidized operators' motivation to support the legislation would be significantly diminished.

Question. I note that MarAd's Study *Reevaluation of U.S. Liner Trade Routes* was issued in September 1984; and the General References and Statistical Publication listed in the Bibliography for that Study are dated 1984 and before.

MarAd's study is, of course, the basis for its proposal to redesignate essential trade routes.

In your judgment, has the situation in our liner trades changed materially in the time since MarAd's study, so that some of the assumptions and conclusions in it need re-examining?

Answer. Yes. Since then there has been a dramatic increase in capacity on some of the trade routes which would be combined. Moreover, the same study was the basis for predictions of what would happen if General Order 80 were revoked. Since then, there has been significant actual experience with unsubsidized service by subsidized operators in the form of the USL round-the-world service which should be analyzed in terms of the impact on USL itself and unsubsidized and subsidized U.S.-flag operators whose services have had to compete with that USL service.

Question. Critics of the current ODS program point out that "in many instances, the Government is actually paying more ODS per ton of cargo under the current ODS system than the shippers themselves are paying to move that cargo."

If this criticism is accurate, would S. 2662 correct this situation, in your judgment?

Answer. That criticism is accurate, but would be corrected by S. 2662. This is basically so because the newer, more productive, and less expensive U.S.-flag line haul vessels combined with foreign-flag feeders to augment U.S.-flag line haul utilization will provide the wherewithal to carry substantially more cargo at a far less level of ODS per unit of cargo carrying capacity.

Question. Under S. 2662, once an operator is entitled to receive ODS, with one exception it can offer liner service anywhere at anytime in the foreign commerce of the United States.

In theory the opportunities of the marketplace would determine the trades that operators served, and the level of their service. We know, however, in the real world this is not the case, because some trades are heavily overtonnaged (e.g., Far East; North Atlantic).

Under S. 2662, therefore, would we run the risk of spending taxpayer dollars to subsidized competing operations which are not only economically unwise, but would have no public interest justification?

Answer. The existing program has resulted in bunching on major trade routes, and subsidized operators have not found it poesible to quickly respond to cargo shifts by reducing or shifting service. That would be cured under the new program. Reduced costs under the new program will create an improved framework for entering trades which cannot be economically served under the current program.

Question. This morning one of the smaller U.S.-flags (Waterman), which did not have an opportunity to participate in the drafting of S. 2662, will oppose several provisions in the bill, and suggest language to remove its objections.

I would hope that after the hearing you could meet with representatives of Waterman and make an accommodation.

Answer. Such meetings have been held and will continue to be held with a view toward reaching such an accommodation with Waterman as well as several other small U.S.-flag liner operators.

Question. Under the present law, ODS is conditioned upon and therefore justified in the public interest upon a finding that it is necessary to maintain adequate U.S.-flag service *trade routes essential to the foreign commerce of the United States.*

Under S. 2662, however, no such finding is required, because ODS becomes an entitlement program and ODS recipients can offer liner service anytime, anywhere, as long as that service is in the foreign commerce of the U.S., and do not include present trade route 18.

What, therefore, is the public interest justification for ODS under S. 2662?

Commercially:

U.S.-flag liner cargo carriage in the trades where liner service is viable, assuring that American shippers and consignees are not limited to a dependence upon foreign-flag operators.

U.S.-flag participation in the conferences and independently in the pricing structure for the carriage of U.S. imports and exports.

Balance of trade and payments benefits of such carriage.

Military:

A ready source of U.S.-flag lift capacity and American officers and seamen in time of national emergency.

Question. Under present law, ODS is available to maintain adequate service on trade routes essential to the foreign commerce of the United States.

Not all trade routes essential to the foreign commerce of the United States are necessarily economically attractive to U.S. operators (e.g. Australia). Nevertheless, the law does offer some incentive to U.S. operators (ODS).

Under S. 2662, however, there would be no ODS incentive, because service on an essential trade route would no longer be a condition of ODS. Is that correct?

Answer. Under current law, an ODS operator is not required to continue an unprofitable service. The benefits of S. 2662; subsidization of modern, foreign-built vessels, service flexibility with those vessels, augmented by foreign-flag feeders, can be expected to provide incentive to reach more areas in the future because of enhanced revenue/expense relationships. The incentive will not be ODS as such, but the much more viable and practical profit incentive.

Question. Present law (Sec. 809(a)) requires that ODS contracts be entered into "so as to equitably serve, insofar as possible, the foreign trade requirements of the Atlantic Gulf, Great Lakes, and Pacific ports of the United States."

Would this requirement remain under S. 2662?

Answer. No.

If not, would there be any assurance under S. 2662 that the "foreign trade requirements of the Atlantic Gulf, Great Lakes, and Pacific ports of the United States would be equitably served?"

Answer. No. But the fact is that under the current program subsidized service does not occur where cargo opportunities are insufficient. Since 1936, no Secretary has designated as an "Essential Trade Route" service between the Great Lakes and a foreign country. Moreover, MarAd virtually as a matter of form issues waivers upon failure to meet minimum sailings obligations in the ODS liner contracts. New program or old, the successful carriers call where the shippers find it in their interest to offer the cargo. That's where the foreign-flag operators call, and that's where the U.S. operators must compete.

Would S. 2662 affect the foreign trade requirements of Alaska and Hawaii?

Answer. No.

Question. According to MarAd statistics, U.S.-flag liner subsidized operators carried only 11 percent of the cargo in the U.S. foreign commerce. Unsubsidized U.S. operators carried 10 percent and foreign-flag competitors carried 79 percent.

Under S. 2662 ODS operators would be free to compete in all of our foreign trades.

Would this lead to a situation where U.S. tax $ (ODS) would be used to subsidize competition between U.S. operators? In other words, in the real world would the result be that more U.S. subsidized operators would be competing for the present 21 percent of the cargo carried by U.S.-flags?

Answer. To be sure, there is certain cargo that the U.S. operators will always carry, and certain cargo that the foreign-flag operators will always carry. However, those ratios clearly are not 79:21 in favor of the foreign operators. Only 10 years ago, the U.S.-flag share was 31 percent. With (1) the more modern, cost efficient fleet, (2) the increased service flexibility, and (3) the foreign-flag feeder support system resulting from enactment of S. 2662, the U.S.-flag liner fleet will have the capability to increase U.S.-flag liner cargo participation significantly.

Question. Under S. 2662 would you receive less subsidy per ship than you are currently receiving under your ODS contract?

Answer. Not applicable to (currently unsubsidized) Sea-Land.

Question. In my view it is absolutely essential in the interest of national security and the welfare of our international water transportation system, that U.S.-flag vessels be manned with U.S. merchant seamen.

Given that requirement, don't we have to face the economic facts of life that the U.S. liner industry will always be faced with a competitive cost differential? In other words, we have to pay the price—"there are no free lunches."

Answer. We could not agree more. Wage parity in order to maintain a merchant seamen work force in time of both peace and national emergency is the raison d'etre of the ODS program. Otherwise, there would be no reason why American shipping companies—as do other American companies engaged in international commerce—should not flag and man their vessels purely on economic considerations. Surely, the motive for American-flag, American crew is not the "privilege" of carrying DOD or other government impelled cargo at rates meeting only incremental costs, at rate levels often well below commercial rate levels.

Senator STEVENS. Thank you very much.

Mr. Bru.

Mr. BRU. Thank you, Mr. Chairman. I am William B. Bru, Chairman and Chief Executive Officer of United States Lines. I take this opportunity to thank you and the subcommittee for the opportunity to be before you today. I am submitting a full text of my statement and would like to just take this time to summarize that text.

There are three related subjects on the agenda for today's hearing: the Liner Development Act of 1986; S. 2662, the Redesignation of Essential Trade Routes; and General Order 80. I will briefly address each one.

Number one, S. 2662, has the full and unqualified support of the United States Lines. Its passage is absolutely essential to the survival of the United States liner flag industry. The restrictions and prohibitions in the Merchant Marine Act of 1936 no longer make practical or economic sense after 50 years.

S. 2662 recognizes the need to establish a fair regulatory environment which eliminates unnecessary regulation while compensating for the higher wage cost of U.S. citizens.

We believe S. 2662 addresses the critical needs of the industry. First, it provides wage cost parity to all operators through a reformed operating differential subsidy system. Second, it provides capital cost parity by allowing acquisition of vessels on the world market. Third, it removes regulatory restrictions which harm our ability to compete effectively with the foreign flag vessels which provide 75 percent of our competition.

United States Lines looks forward to working with the Congress and the rest of the industry to assure the speedy passage of this bill.

Number two, with respect to MarAd's rulemaking proceeding dealing with the redesignation of essential trade routes, United States Lines supports the change and believes the process should be allowed to go forward. Subsidy contracts awarded within the present structure have defined essential trade routes, and narrowly drawn service descriptions substantially undermine the ability of U.S.-flag carriers to compete effectively with foreign flag carriers.

U.S.-flag carriers need the freedom to structure their operations in the most efficient and competitive manner possible, not according to agency mandate.

United States Lines also supports the MarAd rulemaking proceeding dealing with the elimination of current restrictions on unsubsidized operations by a subsidized carrier commonly referred to as General Order 80. The principal effect of MarAd's maintenance of General Order 80 has been to insulate and protect both subsidized and un-

subsidized carriers against fair and effective U.S.-flag competition from nonsubsidized services offered by subsidized carriers.

General Order 80 should be repealed as soon as possible. The inequities of General Order 80 are best illustrated by a brief review of the operations of United States Lines. United States Lines presently operates 12 ECON ships on its round the world service.

These vessels do not receive one dollar of subsidy; however, due to the fact that some of our other vessels are subsidized, the operation and deployment of the ECON ships has been the subject of adminstrative proceedings and Federal litigation for the last 3 years, I might add at much cost to the company and to the Government.

Absent General Order 80, these vessels could be immediately utilized in services which make the most economic sense instead of where agency constraints dictate. Within the last six weeks, United States Lines has abandoned its intercoastal service. As a result, our fleet of 11 vessels which operated between the U.S. East Coast and the Far East on a subsidized basis was reduced to six vessels operating between the U.S. West Coast and the Far East on a nonsubsidized basis.

We took 11 vessels off of subsidy and replaced them with 6 unsubsidized vessels. Nevertheless, because of General Order 80 and despite the fact that we replaced 11 subsidized vessels, the nonsubsidized operation of these 6 vessels has become the subject of proceedings at MarAd and the target of our competitors' protest.

United States Lines presently operates only three vessels on a subsidized basis, and these are deployed in the North Atlantic pursuant to an ODS contract that expires in June of next year. At that time, absent passage of S. 2662, we will be faced with a situation where United States Lines will be off subsidy totally, but its subsidiary, United States Lines, S.A., which operates exclusively between the U.S. East Coast and South America, will continue to receive subsidy pursuant to a separate and distinct ODS contract.

Since General Order 80 applies to the nonsubsidized operations of carriers which are affiliated with carriers which receive subsidy, United States Lines will remain regulated and constrained, even though the company will not be receiving any subsidy.

To sum up, the United States Lines believes that S. 2662 is a reasonable compromise. It is fair and equitable to all U.S. liner companies. It provides the critical lines of fleet renewal, deregulation and wage subsidy, while minimizing costs to the government by limiting operating subsidies and improving the efficiencies of the fleet.

I must tell you, however, that while I appear before you today with my colleagues in total support of S. 2662, United States Lines equally supports the separate and independent competitive initiatives of the Maritime Administration in the two proceedings which I have mentioned.

S. 2662 should not be used as an excuse in any way or in any way hinder, impede or delay the final decision in these rulemaking proceedings. While we understand completely that it is not so intended, the legislative oversight process should be neither used nor perceived as an

indirect device to usurp MarAd's discretion with respect to matters uniquely within its sphere of expertise.

S. 2662 is the long-term solution of many of the ills of the U.S.-flag liner industry; however, our efforts to accomplish the passage of this vital legislation should not be construed as adherence to a position that MarAd should remain impotent in the interim. Certain facets of the bill make sense in isolation and we believe should immediately be implemented.

The pending rulemakings far predate the introduction of S. 2662 and should not be held hostage by its introduction. MarAd must be allowed to function in order to assure that the present intolerable situation does not become worse while the legislative process continues.

Thank you very much.

[The statement follows:]

STATEMENT OF WILLIAM B. BRU, CHAIRMAN AND CHIEF EXECUTIVE OFFICER, UNITED STATES LINES, INC.

Good morning. I am William B. Bru, Chairman and Chief Executive Officer of United States Lines, Inc.

I appear before you today, along with my colleagues in the industry, to convey the full and unqualified support of U.S. Lines for S. 2662. S. 2662 is absolutely essential. It is a breath of fresh air. The Merchant Marine Act of 1936 is now fifty years old. While it has been amended through the years in an attempt to keep it current with the times, it is now necessary to examine many of its basic principles. To this end I am pleased to be with you today to discuss S. 2662 and two related issues which are the subject of rulemaking proceedings at the Maritime Administration—the proposed consolidation of essential trade routes and the elimination of General Order 80.

S. 2662 seeks to maintain an active, competitive U.S.-flag liner fleet. A fleet manned by U.S. citizens and capable of carrying a substantial portion of U.S. foreign commerce and serving as a military auxiliary in time of war or national emergency. It recognizes the need to establish an equal regulatory environment which eliminates unnecessary regulation and compensates for the higher wage costs of U.S. citizen crews. This Committee has heard all too often the litany of woes afflicting the U.S.-flag liner industry and I will not repeat that litany today. I will, however, emphasize that most of these problems are not of our own doing. My own company, which operates some of the world's most competitive vessels, lost a substantial amount of money on operations in 1985 and even more so already this year. Common sense dictates that a statutory scheme developed for the merchant marine of the 1930's may not be appropriate for the liner industry of the 1980's. In fact, it is not. The restrictions it imposes no longer make sense. The ability to immediately react to the dictates of the market place in deciding when and were to deploy vessels must be based on economic and commercial determinations and should no longer be dictated by outdated policy which is protectionist and forecloses competition. The Merchant Marine Act of 1936, designed ". . . to foster the development and encourage the maintenance" of a strong U.S.-flag merchant marine, has developed into a weapon used by American flag carriers against one another. It is counterproductive and it encourages legal shenanigans to achieve competitive advantage.

The problems of this industry are also the nation's problems because a strong U.S.-flag merchant marine is absolutely essential to all of our defense planning. As the Joint Chiefs of Staff have recently stated:

"In any major overseas deployment, Sealift will deliver about 95% of all dry cargo and 99% of all petroleum products. Ships from the U.S. Merchant Marine represent the largest domestic source of sealift making them an important strategic resource."

Mr. Chairman, I am taking the liberty of attaching to this statement a copy of Vice Admiral T.J. Hughes' statement delivered recently to the House Merchant Marine Subcommittee on the issue of the U.S. merchant marine and sealift. No one could have stated the situation better.

PROPOSED MARITIME REFORM

We believe S. 2662 addresses several absolutely critical needs of the industry. First, it provides wage cost parity to all operators through a reformed operating-differential subsidy system. Second, it provides capital cost parity by allowing acquisition of vessels on the world market. Third, it removes regulatory restrictions which harm our ability to compete effectively with the foreign-flag vessels which provide three-quarters of our competition. I will briefly address each of these three main parts of the legislation.

(1) *Parity on Wages.* U.S.-flag liner operators compete directly and continuously with hundreds of foreign flag carriers. yet because for defense reasons the law requires the use of U.S.-citizen seamen, our wage and fringe benefits are higher than those of our foreign competitors. Despite the strong efforts of both operators and unions to reduce wage costs it is impossible to eliminate the wage differential unless the prevailing wage rates in the United States should drop to that of Asian countries such as Taiwan and Indonesia. The stark fact is that, unless the government is willing to make up the difference between U.S. and foreign wage costs, we cannot maintain the U.S.-flag fleet.

Accordingly, S. 2662 provides that the Secretary of Transportation be authorized to enter into ODS contracts and amendments to existing ODS contracts to compensate for the higher wage cost of U.S. citizen crews. These new contracts and amended contracts will apply only to wages, and subsidy for the higher U.S. costs of protection and indemnity and hull insurance, and maintenance and repairs, will, after

a two year transition period, be given up. These new or amended contracts would be made available on a fair and equitable basis to all U.S.-flag liner operators in international trade.

(2) *Parity on Capital Costs.* Because the construction-differential subsidy program has ended, U.S. operators cannot acquire new vessels for operation under ODS contracts. Yet they desperately need to replace small, inefficient vessels with modern, diesel vessels with automated cargo systems. Without these new vessels, U.S. operators will not be able to compete against foreign flag vessels. U.S. jobs will be lost, and U.S. sealift capability will be reduced. The sooner we are able to acquire vessels overseas to replace older ships with higher manning requirements, the sooner we will fully compete with foreign operators, and the sooner the Government can improve the efficiency of the ODS program.

(3) *Regulatory Reform.* The final basic element of our bill, in addition to capital and wage cost parity, is regulatory parity. The Merchant Marine Act of 1936 regulates many aspects of an ODS contractor's business, including specifying what trade routes and ports a company can serve. It also prevents companies from entering into efficient arrangements with foreign operators. Operational flexibility is essential in the liner shipping industry where the overwhelming bulk of our competition is foreign-flag and not subject to similar restrictions. Operators must have the ability to respond to changing trade patterns and service configurations. S. 2662 would thus eliminate existing restrictions on trade routes, foreign affiliations, and unsubsidized services.

Mr. Chairman, at the outset I expressed my appreciation for the opportunity to appear before the Committee today to discuss S. 2662 and two related MarAd rulemakings. Those rulemakings relate directly to this issue of competitive freedom and commercial decision making. They are the Maritime Administration's Notice of Intent To Redesignate Essential Trade Routes published March 8, 1985, in the Federal Register and MarAd's Notice of Intent To Eliminate Restrictions on Non-subsidized Voyages by Subsidized Liner Companies published in the Federal Register on October 7, 1985. We unequivocally support both of these proposals and the comments we submitted to MarAd are appended to this statement.

The current designations of essential U.S. foreign trade routes have not been the subject of any substantial review or amendment since their initial adoption in the 1930's to assist in the administration of ocean mail contracts under the Merchant Marine Act of 1928. They have thus remained in place despite the tremendous changes in technology, shipping patterns and world economic conditions which have transformed the ocean transportation industry and the position of U.S.-flag carriers within that industry over the last 50 years. Subsidy contracts awarded within the present structure of designated essential foreign trade routes and narrowly drawn service descriptions and other restrictions have all too frequently had the effect of perpetuating the status quo operations of subsidized U.S.-flag carriers in the face of rapidly changing market conditions.

The purpose for which the Operating Differential Subsidy Program was established was of course to enable U.S.-flag carriers to compete on equal terms with foreign flag carriers. The subsidies provided under the program enable U.S.-flag carriers to offset the cost advantages enjoyed by foreign-flag carriers. The effectiveness of the program as an aid to competition is substantially undermined however, by the attendant restrictions which are imposed on subsidized carriers. For U.S.-flag carriers to compete effectively with foreign flag carriers, they must match not only their operating costs but also their freedom to structure their operations in what they deem to be the most efficient and competitive manner possible.

The other competitive initiative currently under consideration at MarAd is elimination of the restrictions on unsubsidized operations by subsidized carriers (commonly referred to as General Order 80).

G.O. 80 requires that subsidized operations obtain MarAd's approval before engaging in any non-subsidized operations. A subsidized carrier must apply for authority to conduct non-subsidized operations and its U.S.-flag competitors have the right to oppose the application. The principal effect of MarAd's maintenance of the regulation has been to insulate and protect both subsidized and unsubsidized carriers against fair and effective U.S.-flag competition from non-subsidized services offered by subsidized carriers.

G.O. 80 should be repealed, as soon as possible. The inequities of G.O. 80 are best illustrated by a brief review of the operations of U.S.L.:

1. USL presently operates 12 Econships on its Round-The-World service. These vessels do not receive one dollar of subsidy. However, due to the fact that some of our other vessels are subsidized, the operation and deployment of the Econships has been the subject of administrative proceedings and federal litigation for the last

three years. Absent G.O. 80, these vessels could be immediately utilized in services which make the most economic sense, instead of where agency constraints dictate.

2. Within the last six weeks, USL has abandoned its intercoastal service. As a result, our fleet of eleven vessels which operated between the U.S. East Coast and the Far East on a subsidized basis was reduced to six vessels operating between the U.S. West Coast and the Far East on a non-subsidized basis. Nevertheless, because of G.O. 80 and despite the fact that they replace 11 subsidized vessels, the non-subsidized operation of these six vessels has become the subject of proceedings at MarAd and the target of our competitors' protests.

3. USL presently operates only 3 vessels on a subsidized basis and these are deployed in the North Atlantic, pursuant to an ODS contract that expires in June, 1987. At that time, absent passage of S. 2662, we will be faced with the situation where USL will be off subsidy totally but its subsidiary, United States Lines (SA), Inc., which operates exclusively between the U.S. East Coast and South America, will continue to receive subsidy pursuant to a separate and distinct ODS contract. Since G.O. 80 applies to the non-subsidized operations of carriers which are affiliated with carriers which receive subsidy, USL will remain regulated and constrained even though the company will not be receiving any subsidy.

CONCLUSION

We believe that S. 2662 is a reasonable compromise. It is fair and equitable to all U.S. liner operators. It provides the critical needs of fleet renewal, deregulation and wage subsidy, while minimizing costs to the government by limiting operating subsidies and improving the efficiencies of the fleet.

Mr. Chairman, I must tell you that while I appear before you today with my colleagues in total support of S. 2662, U.S. Lines equally supports the separate and independent competitive initiatives of the Maritime Administration in the two proceedings which I have mentioned. S. 2662 should not be used by anyone as an excuse to in anyway hinder, impede or delay final decision in these rulemaking proceedings. While we understand completely that it is not so intended, the legislative oversight process should be neither used nor perceived as an indirect device to usurp MarAd's discretion with respect to matters uniquely within its sphere of expertise.

S. 2662 is the long term to solution of many of the ills of the U.S.-flag liner industry. However, our efforts to accomplish the passage of this vital legislation should not be construed as adherence to the position that MarAd should remain impotent in the interim. Certain facets of the bill make sense in isolation, and we believe should be immediately implemented. The pending rulemakings far predate the introduction of S. 2662 and should not be held hostage by its introduction. MarAd must be allowed to function in order to assure that the present intolerable situation does not become worse while the legislative process continues.

[The following information was subsequently received for the record:]

QUESTIONS OF SENATOR INOUYE AND THE ANSWERS

Question. The trade route between the East Coast of the United States and the Mediterranean is an Essential Trade Route, is it not?

Answer. Yes.

Question. Doesn't that trade contemplate service in both directions so that both United States shippers and consignees will have U.S.-flag service available to them?

Answer. The Essential Trade Route provisions found in current law contemplate, among other benefits to the nation, the promotion of the foreign commerce of the United States.

Question. Don't Farrell and Prudential both operate round subsidized voyages in those trades?

Answer. It is my understanding that, at the present, they do.

Question. Over the years hasn't the United States paid those two companies collectively over a billion dollars in ODS?

Answer. I don't know. It certainly will have been a substantial amount.

Question. Doesn't U.S. Lines (USL) unsubsidized Round-the-World service now carry cargo from the United States to a French port (Fos) on that trade route, but not any return cargo?

Answer. At the present we do, yes.

Question. And then doesn't USL redistribute the cargo in the Mediterranean with foreign-flag feeder ships?

Answer. Yes.

Question. But Farrell and Prudential can't use foreign-flag feeder ships in the Mediterranean, can they?

Answer. They could if granted a waiver by the Secretary of Transportation under Section 804(b) of the Merchant Marine Act of 1936.

Question. Isn't USL a subsidized operator on other trade routes collecting on a company wide basis much more subsidy than either Farrell or Prudential?

Answer. U.S. Lines has a contractual ceiling of $14.6 million for the current year (6/86–6/87). U.S. Lines SA has a separate and distinct ODS contract for its operations.

Question. Suppose that in this one direction USL service will cause severe economic injury to Farrell's ability to provide this Essential round service. Under these circumstances I have just outlined, don't you think that there is a reasonable basis for that assertion by Farrell?

Answer. That assertion is the subject of litigation currently pending in Federal court and the subject of Administrative Proceedings. It has not been determined to be correct.

Question. But if General Order 80 did not exist, Farrell would have no recourse to MARAD to ask that USL's one-way service on that route be regulated would it?

Answer. That is correct. It must be remembered, however, that the underlying reason for supporting S. 2662 is that the statutory scheme developed in the 1930's to support our merchant marine is not appropriate for the liner industry in the 1980's. The restrictions it imposes no longer make sense. The ability to immediately react to the dictates of the marketplace in deciding when and where to deploy vessels must be based on economic and commercial determinations and should no longer be dictated by outdated policy which is protectionist and forecloses competition.

Question. Currently, doesn't General Order 80 apply if, for example, a subsidized operator between the U.S. Gulf Coast and the Far East wanted to deviate off of its route and call the West Coast of the United States?

Answer. I believe that is correct.

Question. Under such circumstances, is it correct that the subsidized operator would lose some fraction of the ODS otherwise payable for the time he deviates from his normal itinerary to make the off route call?

Answer. I believe that, under these circumstances, the carrier may apply for a "privileged call" and remain on subsidy. Falling that, he would go off subsidy for the deviation.

Question. If so, doesn't the subsidized operator end up collecting only 80 or 90% of the ODS otherwise payable rather than full ODS?

Answer. Under current law, and depending upon the period of deviation, that is probably correct.

Question. If General Order 80 is abolished, couldn't an operator do this without getting any permission from MARAD or concurrence from an unsubsidized operator serving between the West Coast and the Far East?

Answer. Yes, but the operation would not be subsidized.

Question. In those circumstances, isn't the subsdized operator in reality being subsidized for the entire sailing, but at a proportionally reduced amount?

Answer. Conceptually yes. Our prepared testimony supports, as does that of all other carriers, S. 2662, the purpose of which is to put all on an equal footing and eliminate obsolete contraints on vessel operations.

Question. Wouldn't that ODS constitute a competitive advantage to the ODS operator in comparion to an unsubsidized operator's service between the West Coast and the Far East? And yet, if General Order 80 is abolished, that unsubsidized operator would have no opportunity to attempt to prove to MARAD that there was already sufficient U.S.-flag service and that he would be competitively impacted by the subsidized operator deviating off of his trade route to compete with the unsubsidized operator on his trade routes?

Answer. General Order 80 restricts the operations of unsubsidized vessels. As noted in my testimony, the principal effect of MARAD's maintenance of G.O.80 has been to insulate and protect both subsidized and unsubsidized carriers against fair and effective U.S. flag competition from non-subsidized services offered by subsidized carriers. I will not repeat it here, but refer you to the example of the inequities of G.O. 80 beginning on page 7 of my testimony.

Question. Under the present law, ODS is conditioned upon and therefore justified in the public interest upon a finding that it is necessary to maintain adequate U.S.-flag service trade routes essential to the foreign commerce of the United States.

Under S. 2662, however, no such funding is required, because ODS becomes an entitlement program and ODS recipients can offer liner service anytime, anywhere, as long as that service is in the foreign commerce of U.S. and do not include present trade route 18.

What, therefore, is the public interest justification for ODS under S. 2662?

Answer. We do not believe the public interest is served by maintaining the antiquated restrictions on efficient and competitive operations currently found in the Merchant Marine Act of 1936. The public interest justification for ODS under S. 2662 is clearly stated in Section 2 of the bill and we will not attempt to improve on that.

Question. MARAD has two rulemaking pending: Repeal General Order 80. Redesignate the 27 Essential Trade Routes into 8 Trade Areas.

The Administrator has requested legislation to: Permit ODS opertors to build foreign.

If these proposals went into effect would you still want the legislation you are supporting here?

Answer. Yes. It is not realistic to expect that a U.S. carrier, employing U.S. crews, can operate profitably without some form of wage differential support, even without the other handicaps on capital costs and operating flexibility.

Question. Critics of the current ODS program point out that "in many instances, the Government is actually paying *more* ODS per ton of cargo under the current ODS system than the shippers themselves are paying to move that cargo."

If this criticism is accurate, would S. 2662 correct this situation, in your judgment?

Answer. We are unable to comment on the quote. It must be remembered, however, that ODS is simply an attempt to place the U.S. operator who employ U.S. citizens crews on relative parity with his foreign flag competiton. We can say with certainty however that S. 2662 will result in lower ODS per ton of cargo moved than the current system.

Other questions submitted to U.S. Lines are identical to those submitted to the members of Panel #1. U.S. Lines concurs in their responses.

Senator STEVENS. Thank you very much.

Mr. Drozak.

Mr. DROZAK. Mr. Chairman and Members of the Subcommittee:

My name is Frank Drozak and I am President of the Seafarers International Union of North America, AFL-CIO (SIU) which represents thousands of unlicensed seamen aboard U.S.-flag vessels. The bill before the subcommittee today S. 2662, is of interest to the SIU for two very important reasons—its future will determine not only the future of the U.S.-flag liner industry, but also the future employment of our membership.

The policy of Providing for the national security of this Nation as well as advancing our foreign commerce is necessarily one which can only be addressed by a unified and equitable maritime policy. S. 2662 attempts to address this objective by streamlining the present operating differential subsidy system and by adopting a new regulatory framework that will serve to decrease Government regulation and thus help eliminate the present inequities in treatment between competing U.S.-flag liner carriers.

Mr. Chairman, the need for this legislation and the relief it would bring to our liner operators has never been more clear-cut. One need only look to the corporate balance sheets of the comPanies represented here today to realize the urgency and severity of the situation. Over the past couple of years I have stated, as have others, that unless substitute programs to those embodied in the 1936 and 1970 Merchant Marine

Acts are adopted, our American Merchant Marine will all but disappear. Unfortunately, these predictions I fear are coming closer and closer to reality. The bulk side of the industry already is severely depressed and, as evidenced by today's hearing, the liner industry is experiencing its most difficult time in history?.

Current regulatory policies in the United States leave an American operator with few choices for the future—he either can reflag all or a portion of his fleet foreign or he can remain under the U.S. flag and face possible bankruptcy proceedings. Neither alternative iS acceptable to this union, nor in our opinion should it be acceptable to this Nation or its citizens.

The number of American-flag liner companies has been reduced by one-half in the last 15 years. The reason for this decline is simple—the lack of a consistent, continuing, fair and effective national maritime policy. In order not to rePeat the recent past, and save what is left of this vital component of national defense, Congress must approve a viable replacement for the present ODS system and its accompanying regulatory impediments. We believe that the approach taken by S. 2662 is an appropriate one.

While our general support for this bill is clear, we do have a number of observations and concerns which we would like to discuss. One of the key provisions of this bill is section 619 which authorizes qualified liner operators to receive subsidy on foreign-built vessels. This is perhaps the most striking departure from present policy, yet in the absence of a viable government assisted construction program, a necessary departure. The realities of world shipping economics are so overwhelming that to do otherwise would serve only to guarantee a fast death for the liner industry. The authority to build abroad, however, must be an exception and not the rule for future maritime policy.

This nation cannot, and must not, allow its shipbuilding mobilization base to fall below its present levels. Unfortunately, without some form of government help, our commercial shipbuilding capability will all but disappear in a very short number of years. We therefore urge this Subcommittee to continue in its efforts to develop a government program to assist our ailing shipbuilding industry. For its part, the SIU pledges its continued support and assistance in seeking the adoption and funding for a mariner type construction program, or any other shipbuilding program deemed appropriate.

Another key provision of this legislation would permit the expanded utilization of foreign-flag feeder vessels. While recognizing that, by law, a number of these vessels must have foreign registry, we believe that a portion of the remainder should be American crewed and eligible to receive operating subsidy. Such a policy would certainly further the Policies of this act and help insure a strategically positioned pool of trained seamen around the globe in time of emergency. At present, the majority of these feeder vessels are manned by foreign crews with no political or other ties to the United States. Thus, even if these vessels were to be made available for America's use in a war type atmosphere, who would man and sail these ships into the war zone? I think the

answer to this question lies in a resolution recently adopted in Geneva by the Seafarers section of the International Transport Workers' Federation (ITF). That resolution essentially states that the merchant seamen members of the ITF affiliates reserve the right not to proceed on vessels bound for war-like operations areas. The ITF includes in its membership maritime unions from over 50 nations on six continents. The resolution, which is attached to my statement for the record, was adopted by every member union except those of the United States. In light of this resolution and the clear message it should send to our defense planners, we would urge the subcommittee to give serious consideration to extending subsidy to a portion of the American-owned foreign-flag feeder fleet so as to ensure a pool of trained seamen willing to sail with our merchant vessels into the theater of war.

Also of concern to us is the legislation's potential infringement on our domestic trades. The SIU supports inclusion of a grandfather clause which permits the continued operation of existing mixed services by liner operators which are presently subsidized or who may in the future become subsidized as a result of this bill. The SIU is opposed, however, to any future mixed services that would be in addition to or beyond that offered by any carrier today.

Mr. Chairman, aside from the economic and operational reasons as to why this legislation is necessary, there are two different aspects of national security involved which must be considered as well. The first is the necessity for this country to maintain an adequate number of U.S.-flag ships to be able to execute the forward defense strategy of this nation. We must be able to deploy our forces wherever needed. Our defense posture is built on deterrence and to be effective, it must be credible. We can spend billions of dollars on military capability, but if we lack the strategic mobility necessary for rapid deployment, then we lack credibility. For this reason, dollars, which are spent on improving our strategic mobility capability, are highly leveraged dollars which permit the full

use of the billions spent on defense. Yet we have only seen reductions under this administration toward the private maritime industry.

The second aspect of national security is that of manpower. Because of the decline in the number of militarily useful U.S.-flag merchant ships, the Navy has created a variety of programs to make up for the shortfall in available shipping assets in time of war. Many of these are active ship programs, such as the Afloat Prepositioning Force ships which are at sea on a daily basis. Others, however, are ships that are laid up and require activation and manning when needed. Active, trained merchant mariners are needed in sufficient quantities to man these ships.

Today the Navy has more than 70 ships in the Ready Reserve Force (RRF) that need to be activated in five to twenty days in time of war. There are 13 others that were bought earlier this year and will join the RRF this fall. There are eight former Sea Land SL-7s that are partially manned and kept in a four-day readiness status. By the end of the year one of the Navy's two hospital ships will be completed and both of the

aviation support ships will have completed conversion and be delivered to their lay berth sites. That is a total of about 96 ships that represent a manning problem today in the event they are needed.

The Navy currently plans to increase its pool of government-owned vessels to about 150 ships by 1992, further compounding the manning requirement for trained seafarers in time of war.

The current 400 active U.S. flag deep sea vessels, along with a few government-owned, civilian-manned Military Sealift Command ships support a manpower pool of about 29,000 merchant mariners. This seafaring manpower pool rotates through approximately 14,800 peacetime billets which Provide daily employment, a ratio of about 1.9 mariners for every at-sea job. The Navy counts on those who are ashore at any given time to man the government-owned, laid up ships in time of war. Studies show that a minimum of about 1.5 mariners are needed to support every seagoing billet, but when you add the wartime requirement of nearly 4,500 to man today's laid up ships, the ratio drops to the minimum level of 1.5 to one, and in fact, actually produces a shortfall in seafarers of between 1,000 to 2,000 who will not be available when required to meet national defense requirements. By 1992, if the Navy follows through on its plans to have nearly 150 ships laid up, there will be a predictable shortfall of between 5,000 and 6,000 mariners—and the number could be. higher depending on your estimate of how many will answer the call.

In conclusion, Mr. Chairman, the SIU strongly believes that this legislation, S. 2662, is a major step towards strengthening both America's maritime industry and national security. We believe that it is a good first step to not only protect U.S.-flag liner carriers from further competitive inequities, but also in reversing the trend toward a second-class U.S.-flag fleet by insuring that our carriers have greater opportunities for future growth and a more reasonable level of participation in our foreign commerce. And although the SIU. like others here today, has a number of concerns with the legislation as drafted, we feel confident that any outstanding differences and concerns that we may have can be resolved through continued discussions with labor and management. We therefore encourage your support for S. 2662, and urge this subcommittee to faxcilitate its approval and eventual enactment.

Thank you.

Senator STEVENS. Thank you very much.

Mr. Abely, your company provides important service to my State in the coast-wise trade. If this bill is enacted, will it affect your ability to continue to serve my State?

Mr. ABELY. Not at all, Senator. It seems to me that the bill as drawn in no way adversely affects service either to Alaska or Hawaii. It certainly offers the possibility of some expansion of that service in the foreign commerce.

With respect to our own program for Alaska, as you know, we are presently building three new diesel-driven ships in United States shipyards to serve the State of Alaska. These will provide both an expansion of our capacity to serve the Alaskan trade and a reduction in

our costs, which over the long term I would assume would be translated into rate as well.

Senator STEVENS. Thank you very much. I hope that is the case. I am going to have to explain why we are involved in this bill to the people at home some day. But we will deal with that later.

Mr. Bru, if S. 2662 is not enacted, you have explained your position on General Order 80. If it is enacted this year in a reasonable and prompt fashion, you are prepared however to accept the legislation as an alternative to General Order 80?

Mr. BRU. Senator, we are totally prepared to accept the legislation. However, in reality the legislative process could take long. Hopefully, we can get it done quickly. But in the interim, our company particularly is looking at various deployments of our fleet that more reflect the economic nature of our business today, and we feel that it is essential and very important that we go ahead with the process that the Maritime Administration has spent many, many hours working on, and move forward with General Order 80.

But we do totally support the legislation and are certainly hopeful that it will pass quickly.

Senator STEVENS. Mr. Drozak, one of the major questions is the impact of this legislation on costs, particularly labor costs.

I have to tell you that my good friend sitting to my left, Brad Gilman, has told me we have had a question raised as a result of a series of letters to members of the Senate Commerce Committee urging them to become familiar with this legislation.

The question relates to the potential for a substantial demand for increased labor costs should this bill pass.

Can you comment on that? Is this going to bring about requests for increased labor costs?

Mr. DROZAK. Mr. Chairman, I would hope not. And I do not believe it will happen because unions have recognized—and I can only speak for myself and also say what I have seen happen in recent months there—have met with the shipowners and have recognized some of the problems and have made certain concessions within the last several months.

And particularly this union has reduced the cost of the operator to the point of about 40 percent. Some of the rest of the unions, I believe they run anywhere from 25 to 30 percent, and they could speak better for that than I could, but they have made an attempt.

I do believe—and again not speaking for them—that in our meetings and discussions jointly with the shipowners and also with the union separately, that they recognize that there is a give and take in this situation. I can say to you here for the record that the SIU will not, recognizing the conditions and the seriousness of what is out there and trying to revitalize this maritime industry.

We would, though, expect cost of living based on increase of the cost of living in this country and I am certain that is no more than asking for fairness.

Senator STEVENS. I am pleased to hear you say that. I think everyone realizes what we are really trying to do is prevent the loss of some 10,000 to 20,000 thousand jobs. As I said at the beginning, I cannot conceive of a situation where the intent of the legislation would be destroyed by demands from the labor sector to take advantage of the additional funding base relating to ODS contracts for non-subsidized carriers.

Mr. Abely, did you wish to comment on that?

Mr. ABELY. Yes. I would support what Frank has said on that. I know that the Adminstrator made some comments earlier about effecting the necessary disciplines on the companies to control their cost.

I would have thought that in today's environment, everyone would understand that all of the companies have faced a very difficult environment, have taken every step that they can find not just to control, but to reduce their costs.

And in the labor area, with respect to our own relationships, I think it is worth noting that in bargaining with the shipboard unions over the course of the last 18 months, without a contract being reopened, we have reached agreement with the shipboard unions to reduce the crews on our diesel vessels from 35 to 21. That was done through bargaining and did not involve anything of a concessionary nature from management's side. The unions recognized that the vessels were capable of operating with world standard crew sizes and they acceded to that through the bargaining process.

It is also true that in negotiations with the major shipboard unions in the past two or three months, that all of them have granted additional concessions on the cost side through that bargaining, and I would expect, as Mr. Drozak expects, that the collective bargaining process here will continue.

I do not, for my own part, anticipate that the economics of operating one of the companies that are before you today are going to be any easier for the next two or three years, and I think that pressure on cost is very much a part of our lives. It is recognized by the managements. But I think it is fair to say, Senator, that it has been increasingly recognized by the unions as well.

Senator STEVENS. Thank you very much.

Mr. Drozak, I think you and the SIU deserve a lot of credit for your work with all of us trying to find a medium ground, a middle ground, a consensus ground for final approval of legislation such as this.

Senator Inouye.

Mr. DROZAK. Mr. Chairman, just one point if I may. I mention in my statement about the foreign flag feeder ships, and I understand thoroughly that there is no subsidy money at present for this, but I would like that language be put into the bill because someplace along the line there may be some appropriation of additional monies, and we would not have to go through the process of legislating again on the question of the foreign flag feeder ships. I want to just clear that up on behalf of my statement there.

Senator Inouye.

Senator INOUYE. Mr. Chairman, like the distinguished people who have appeared before us, we too see the dark cloud of chapter XI hovering over some U.S. operators, and we are aware of the dangerous possibilities if nothing is done, and we permit the present status to continue.

The Chairman of this committee has indicated this morning on several occasions and at other times of our serious intention to get this bill across. We think the opportunity is here with us and we believe that even with the seven weeks of legislative days remaining, we have an opportunity of not only passing this bill in the Senate, but also being passed on to the President for his signature.

That would require not just loose consensus, but an agreement among all parties involved. As of this moment, I gather there is a loose consensus of sorts, but I also get the message that if MarAd goes through with the rulemaking on General Order 80, that the loose consensus that seems to be present here now may not continue. Thus, repeal of General Order 80 and would not be in the best interest of the passage of S. 2662.

I therefore hope that the MarAd officials have noted this, and I for one would like to add my voice in pleading with MarAd to hold on and hold the line and give us an opportunity get this measure through because I am of the firm belief that we can do it.

The Chairman of the committee has a legislative plan already in the making. I am certain at an appropriate time he will advise all of you and the media as to how he proposes to do it. It is a realistic approach. It can be done, and with your help it will be done.

Now, having said that, I am certain all of you agree that the major concern of our colleagues, not only in the Senate but in the House, will be dollars.

I asked this question of the other panel. In 1969, the average cost of ODS per shipyear per vessel was $666,000. The 1987 MarAd projection is $3.7 million per shipyear. Do you believe that the passage of this bill would reverse that trend?

Mr. ABELY. I do, Senator. I think that in looking even at the $3.7 million per shipyear, that is an average, as you know. The subsidy on some of the vessels on a ship basis goes over $4 million. That has to do, as Mr. Amoss pointed out earlier, with the older vessels which are not automated and which have significantly larger crews.

My own view is that this bill will enable much more reconstruction and new construction on the part of the Merchant Marine; that new construction certainly will be in diesel vessels; they clearly will be significantly larger than the vessels that they replace which may indeed offer some opportunity for reduction in number of vessels, but as they will be modern, automated diesel vessels, they clearly will be coming in with crew sizes at probably the 21-man level which is the present world standard.

That suggests that over time, on the basis of present dollars, the average which is presently $3.7 million would move toward an average for diesel vessels which, if calculated today, would be approximately $2.5 million.

That would be the subsidy cost of a 21-man vessel, automated vessel, on the basis of today's formula. So I would think that both on the basis of numbers of ships and sizes of crews, that that number would come down.

I would have, I think, one other thought and that is that because the present differential is measured principally against crews from the developing countries. My sense is that as those countries develop, their wage costs will rise more rapidly than wages in the developed world. This is fairly standard as countries develop.

So that I think just on the basis of economics over a longer period of time, the cost differential itself between manning with a United States crew and manning with a Taiwanese or a Korean crew, just to take two examples, would probably shrink over that period of time anyway.

Senator INOUYE. I think history has shown that that trend is being followed at the present time.

I would like to join my Chairman in commending Mr. Drozak for the actions taken by his union. It is often times very easy to express thoughts on concern for the plight of this industry, but to implement those concerns into action can be very difficult and I know that as a leader of this great union it was not easy to implement concerns of that sort when the cost of living may be going up elsewhere.

So I would like to commend Frank for what he has done.

I asked this question of the last panel, but I would like to ask Frank Drozak. Every military leader involved in strategy, in geopolitics, has said in most emphatic terms that if we are to find ourselves in warfare, we would need a viable ready reserve fleet, not just the ships, but personnel to man these ships.

Am I correct in listening to your testimony that it is your view that if the present situation is permitted to continue, this ready reserve fleet would not only be unviable but nonexistent?

Mr. DROZAK. That is correct as I view it, Senator, because right now—I believe in my testimony I point out what the average manager, qualified manpower is available now. And you have got in the ready reserve some 50-60 ships. If you reached 152 ships by the year 1992, our figures show us we are going to have a shortfall of five to six thousand people that would be required just to man those present ships. So it is a bad situation.

The other thing that bothers me, Senator, and it has been said so many times, that if we were involved in a conflict, we may could supply presently with what we have got the supplies necessarily needed for a 30-day war. After that, we are in bad shape.

So for that reason, I think we have got an awful lot of problem. I, too, Mr. Chairman, while I am talking about it, happened to be present and chaired part of those meetings over in Geneva. That was, incidentally, a joint meeting between shipowners, seafarers, and governments.

And, believe it or not, there was only one government and only union from one country that opposed that resolution on entering into an war-like zone.

That resolution is very important. That resolution will come up in October of next year at the ILO Convention. They predict it will pass by 90-95 percent. So it tells us what we have been trying to say here and other people have been telling us, that we can depend on the NATO nations or the Flag of Convenience, et cetera, et cetera, is not so. And I think it is about time that somebody begins examining this thing real seriously.

Senator INOUYE. In other words, you will agree with me that it would be cost-effective from the standpoint of the defense of this country to pass this measure.

Mr. DROZAK. I do, yes. I absolutely do.

Senator INOUYE. It would be cheaper for DOD.

Mr. DROZAK. It would.

It would also, Senator, be cheaper if the would take those 50 or 60 ships out there and put them in, put crews on them, rather than paying $1 million or $1.5 million for them to be laid up in the fleet up there, and they would have available people out there.

While I have the floor, I want to thank you and Senator Stevens for all your work you put. If it had not been for your efforts in putting up with—excuse my French—our bullshit and harassments and et cetera and so forth, we would not be sitting here today. And we certainly, I think, all of us, owe you and Senator Stevens a vote of thanks for what you have done, and I would also like to thank the other maritime unions for their cooperation.

It has taken cooperation on all sides to get to where we are today, and I believe while we have differences of opinion on some of these issues, I think the proper procedure is to move ahead with this legislation. We feel that we can work out some of the issues with the shipowners that we have, and we certainly believe that the question of the domestic trade, I am sure that you both have an interest in that, and I think with those type of situations, I believe we can move forward with a bill if you give it to us.

I will do my best for it, believe me.

Senator INOUYE. Mr. Bru, I asked this question of members of the other panel. This bill will permit ODS operators to enter into space charter agreements with foreign flag line operators. And one can argue under that set of circumstance that instead of competing with foreign flags, you may be cooperating with them, which would be contrary to the concept of the ODS.

What are your thoughts on that?

Mr. BRU. Senator Inouye, my thoughts that if you enter into a space chartering agreement, whether it be with a foreign flag carrier or even another American flag which the '84 Act permits, as well as this legislation would permit, you would only be doing it to gain efficiencies and yet would still be competing with that foreign flag carrier or that other American flag carrier that you entered into the agreement with.

I do not think that it would minimize the competitive impact at all. It would just bring in efficiencies of operation if that need be, in the given trade lane. And it could be a long or a short-term arrangement. But I do not think it would eliminate competition at all between the two lines.

Senator, if I may, I would like to make one comment on your previous question to Mr. Abely that has been certainly very ably handled by my other colleagues, but I would like to add one comment. In the '60s when the subsidy was in the $600,000 range per vessel versus what it is today, the fleet was predominantly—the American flag fleet was predominantly break bulks ships, a few converted container vessels, and in the late '60s first generation container ships.

The modern container vessels that we handle today that we all are buying today have productivity of those earlier vessels of anywhere from five to ten vessels. They can handle the same amount of cargo as five, depending on the size that you are referring to, so from a productivity standpoint on a subsidy ton basis you are getting much more for your dollar probably today than you were in the '60s.

I just would like to add that; that we have increased the productivity considerably.

Senator INOUYE. My final question: Under the present law, the financial records of ODS recipients must be kept in accordance with DOT regulations and the Secretary of DOT has a right to examine and audit the books, et cetera.

If I read S. 2662 correctly, these rights that the Secretary has under the present law seem to have been taken away. Now, was this an oversight or was it deliberate?

Mr. Abely.

Mr. ABELY. We have talked about that amongst ourselves; that is, amongst the carriers, Senator. I think it would be fair to say that that was an oversight. I do not think on the basis of the discussions that I have had at least, that any of the carriers would resist reasonable reporting requirements as a quid pro quo for performing under a subsidy contract, and certainly we would not.

So I think that language can surely be found that would meet that requirement, and I can assure you that we would support that just as we support the bill as it is now before you.

Mr. BRI[illegible]. We completely agree with that, Senator.

Senator INOUYE. Well, I thank you very much. I have a few other questions that I would like to submit, but I would like to thank the panel. It has been most helpful.

Senator STEVENS. We appreciate it very much, gentlemen.

The next panel is Mr. Hearn, senior vice president, Waterman Steamship Corporation and Edward L. Merrigan, counsel for the Central Gulf Lines, Inc.

Good morning, gentlemen, we are happy to see you here. Mr. Hearn, you will be first. Please state for the record the name of the gentleman with you.

STATEMENTS OF GEORGE H. HEARN, SENIOR VICE PRESIDENT, WATERMAN STEAMSHIP CORPORATION, ACCOMPANIED BY JOHN MEADE, ATTORNEY; AND EDWARD L. MERRIGAN, COUNSEL, CENTRAL GULF LINES, INC.

Mr. HEARN. Yes. Thank you, Mr. Chairman.

I am representing Waterman Steamship Corporation. I am accompanied by our attorney, John Meade.

At the outset I would like to certainly thank you as Chairman of the Committee and Senator Inouye for all the help and cooperation that you have given us, and would like to say, since the meeting we had that you chaired last fall, that our company has made every effort to cooperate with all the carriers and attend all the meetings we have been invited to, both on the west coast and in Washington and New York.

I would now like to summarize my formal testimony if I may. I am here to testify first today on the deregulatory program of the Department of Transportation as to the United States flag merchant marine. I use the words "deregulatory program" because DOT has carried out a consistent pattern of complete deregulatory actions. These include much more than the two administrative proposals which are subjects of this hearing, namely the proposals to eliminate General Order 80, which protects against unfair competition by subsidized operators with vessels not named under their subsidy contracts, and the proposal to eliminate United States essential trade routes.

The latter would eliminate the historical trade route protection afforded subsidized operators who operate higher capital cost ships because they were built in the United States. It is appropriate to consider S. 2662 together with DOT's deregulatory program, because these two subjects are necessarily connected. Our point in discussing the deregulation of the non-subsidized unsubsidized voyages and elimination of trade routes is not to get into every detail of the proposals. I will simply point out that those proposals, like the rest of the deregulatory program, have been shown by Waterman in its comments filed with the Maritime Administration to be based upon faulty factual premises and assumptions.

The Freedom of Information Act request by Waterman concerning the backup for statements regarding the supposed benefits of the non-subsidized voyage deregulation show that MarAd had no backup for its statements as to the benefits of this move. Similarly, Waterman's detailed examination of the study purportedly supporting the elimination of trade routes shows that there were no real benefits connected with the redesignation other than a few isolated opportunities for operators to avoid hearing proceedings under section 605(c) of the act. Section 605(c) is the section which determines the question of whether the United States flag service is already adequate or whether the Act's purpose would be furthered by additional service.

MarAd's dockets R-104 and R-105 are part of DOT's program. Purporting to establish reasonable rates, the proposals in these dockets would lower preference cargo rates below remunerative levels for

United States-built ships such as Waterman's. Like the rest of the deregulation program, MarAd's dockets R-104 and R-105 rest on incorrect assumptions—that there are some costs which operators can control but have not yet controlled. There are only two areas, of costs MarAd can have in mind: labor costs and fuel costs. The operator of U.S.-built ships cannot change its fuel costs without the prohibitive expense of changing its vessels' engines, and labor costs are the result of collective bargaining, based on the standard of living we enjoy here in the United States.

Waterman submits that this Committee should be informed and should participate in free, open, and most importantly, fully informed discussions of the basis for and the effect of MarAd's deregulation of the United States flag industry, which obviously has not benefitted any members of the industry.

The remainder of my remarks will be devoted to the effects of S. 2662 on Waterman and what provisions Waterman believes would be fair and reasonable in such legislation, provisions which would not be detrimental to the other United States flag carriers.

The overall question Waterman must ask regarding S. 2662, Mr. Chairman, is why in this era of deregulation under a bill which purports to be deregulatory, Waterman must be punished for its position as a participant under the 1936 Act and must be prevented from immediately beginning a program to become competitive with foreign flag operators. It is nonsensical except as a prescription for Waterman's demise.

Benefits of the administrative deregulatory program are already enjoyed by other U.S. flag carriers who, while nominally subject to the provisions of the 1936 Act, have been allowed to operate foreign flag vessels, unsubsidized vessels, and to the extent that procedural niceties and the accidents of administrative procedure have allowed, even unnecessary subsidized vessels in direct, fighting ship competition with Waterman. Yet here we have a piece of legislation which hinders Waterman from starting a conversion program to become fully competitive with foreign flag operators until it is able, with its reduced financial resources, to fully convert to the new program. Then, Waterman is restricted to a number of vessels with which it cannot ever operate a fully competitive service.

All this is to say nothing of the consideration that Waterman not so long ago was operating a fleet comparable in number to the fleets of carriers who are now operating substantially more vessels and who will be locked into this program on the basis of these current fleets. There is, moreover, some lack of clarity in the legislation as to what benefits will be given to other carriers who have never participated under the 1936 Act, and what opportunities they will be granted to compete with Waterman for its essential cargoes and drive rates down during a period of changeover in the program.

The effects of S. 2662 on Waterman would be: one, S. 2662 withdraws contractual benefits, including $7.5 million in ODS and effectively terminates Waterman's contracts in 2 years. Two, S. 2662

withdraws the 1936 Act contractual rights Waterman has earned by fulfilling the subsidy obligations The bill. A, dilutes trade route protection. B, denies protection from unfair competition by foreign flag or non-subsidized competition. C, it eliminates judicial determination of unlawful USL competiton and other unlawful competitions, and D, it withdraws the 3-year waiting period for foreign-built vessel preference carriage.

Three, S. 2662 gives Waterman's competition, both U.S. and foreign, unfair competitive advantages by, one, giving Waterman four ships versus 20 ships for each of the other contractors; two, establishing an unrealistic two-year election period for contract amendment and requests for additional vessels; three, denying Waterman's equal opportunity to operate competitive vessels; and four, denying Waterman's existing contract entitlement status.

Specifically, Waterman asks the following. One, that it be allowed to stay under the existing contracts as entitlements under the 1936 Act until we elect to go on the new program. The sooner the better, or the sooner we can be more competitive would be helpful to us. Two, that we have our contractual protections under the 1936 Act, including protection from competition by subsidized operators without section 605(c) or General Order 80 procedure. We ask that Congress reaffirm 605(c) and General Order 80.

We ask also for protection from foreign-flag competition by subsidized operators without section 804 procedure, and we ask that Congress reaffirm today section 804. And finally, no legislative intrusion into current or future 605(c) sections or section 804 or General Order 80 cases that are currently existing in the courts. And also, finally, that we be able to build or charter foreign immediately if we so desire.

Waterman simply asks for revival of the continuation of the 1936 protections and intent for the preference laws and continuation of those protections to give it the opportunity to operate a fleet competitive with United States and foreign flag competition while it converts to the new ODS program.

Simply stated, we wonder why the other carriers need our cargo or need to drag down the rates while Waterman is making an effort to convert to the new program.

Thank you very much, Mr. Chairman.

[The statement follows:]

STATEMENT OF WATERMAN STEAMSHIP CORP.

This testimony would be incomplete if it dealt only with Docket R-100 (the proposal to take away General Order 80 restrictions on subsidized operators' "non-subsidized" voyages) and the Trade Route Redesignation Proposal. Those subjects can only be understood in the context of the entire administrative deregulation program which the Department of Transportation (hereinafter referred to as "DOT") has undertaken.

DOT's deregulation program is being implemented not only by these two proposals, but also by the Maritime Administration/Maritime Subsidy Board's administration of G.O. 80, as well as of sections 804 and 605(c) of the Merchant Marine Act, 1936, which protect against unfair foreign-flag and unnecessary subsidized competition by subsidized operators. The Maritime Administration (hereinafter referred to as "MarAd"), in its Dockets R-104 and R-105, is also proposing methods for calculating preference cargo rates which are intended to make the carriage of preference cargo unprofitable

for an operator of modern U.S.-built ships such as Waterman Steamship Corporation (hereinafter referred to as "Waterman"). The proposal discriminates against U.S.-built ships and would frustrate Waterman's efforts to acquire more competitive ships and change over to any new ODS program. We would be happy to furnish complete details of this deregulation program, but we will not burden the record at this point. Suffice it to say that DOT has taken a totally new policy direction with regard to the 1936 Act

Just one example of DOT's administration of the 1936 Act was its unlawful decision to allow unsubsidized competition by a subsidized operator against Waterman. On review, the U.S. District Court for the District of Columbia found MarAd's actions to be not only unlawful but "deceptive." It also found the MarAd's actions in granting the approval so unjustified that the Court, under the Equal Access to Justice Act, awarded Waterman attorneys' fees against the government which Waterman incurred in bringing the case. This award of fees was based on a court finding that the MarAd's actions were not even "substantially justified."

The deregulation program seems to be based solely on economic theory, without regard to the 1936 Act's policy, past administrative policies or any policy considerations as to the value of a Merchant Marine as a whole or the value of diverse operators in the U.S.-flag Merchant Marine. Waterman does not believe that a policy change of 180 degrees should be made in private by a few members of the Executive Branch.

Waterman believes that not only should a policy decision of this magnitude be made in the open with full and intelligent discussion and the balancing of alternatives, but that it should be made by Congress and Congress alone. A senior DOT official has gone so far in a public forum as to consign Waterman and various other members of the U.S.-flag Merchant Marine to the trash heap. The official said that Waterman Steamship Corp., Farrell Lines and Prudential Lines are going to have to find someone with deep pockets in order to survive. He said another carrier, United States Lines, is losing money and may be headed down the same path as the other three. We find it amazing that DOT would make such a public statement, with its attendant negative effects on the operators concerned. It seems DOT has made the determination that much of the U.S.-flag Merchant Marine is expendable and is now making self-fulfilling prophecies to that effect. It would seem that a U.S.-flag operator of 67 years' standing would not be dismissed so casually by the Merchant Marine promotional agency.

We do not believe Congress would agree with DOT on the expendibility of an operator such as Waterman, which has acted in furtherance of the policies of the 1936 Act, even to the point of building new ships in the U.S. (as ordered by MarAd) when Waterman told MarAd the new buildings were imprudent. We do not see how Congress could agree that those who participated faithfully in the policies of the 1936 Act can be abandoned, if only because MarAd has not offered a supported, logical or well thought-out substitute for these policies. DOT's policy had seemed to favor foreign-built vessels and round-the-world services, but that policy has not succeeded. No DOT policy is offered to assist the industry, just more "deregulation" which has helped put us all where we are today. We are not against elimination of unnecessary regulation, but blind deregulation is folly in that it ignores all the complex factors working in the non-"free" international shipping market.

Waterman believes that the only hope for the Merchant Marine is for all members to be treated fairly and equally, and be given an equal opportunity to become fully competitive with foreign-flag operators. It was the most fundamental underpinning of the 1936 Act, based upon abundant legislative history (which we would be happy to supply), that subsidy should not be paid for one U.S.-flag operator to compete with another. Waterman believes that principle should still apply. Waterman also submits that DOT should faithfully execute the policies of the 1936 Act until the Congress has enacted a new program with a coherent policy treating all operators fairly and allowing all operators full freedom to become competitive. With the manner in which DOT is administering the Act, Waterman has to fight in court for every aspect of the Act's protections.

In our testimony before the House Committee, we stressed the need for rationalization of capacity in light of today's extreme overtonnaging. We pointed out the prevalence of rationalization agreements among foreign-flag operators at that time and we once again point out the unabated stream of such agreements. Now there is even

action by the Japanese government to foster rationalization among Japanese carriers. Our concept fell upon deaf ears. We therefore must turn our attention to the provisions of S.2662 as introduced and relinquish our concentration on the concept of rationalization.

Our only alternative now is to point out the unfairness and illogic of this Bill, in that it punishes Waterman for assuming and carrying out obligations pursuant to ODS contracts made under the 1936 Act and hampers Waterman's competitiveness. The Bill would deny Waterman the benefits of the contractual and statutory obligations owed it in law and fairness by the United States, which Waterman earned by entering into ODS contracts and by building new tonnage in U.S. yards at great expense, even to the point of financial losses which contributed to its filing of Chapter 11 bankruptcy. The Bill, on the one hand attempting to deprive Waterman of much of the protections it has earned under the 1936 Act, on the other hand confines Waterman to an inferior status and puts us in a straightjacket which would prevent Waterman from becoming fully competitive, after Waterman has fought its way out of bankruptcy.

The DOT deregulatory program, which includes an effort to reduce cargo preference rates below remunerative levels, lacks a long-term, well thought-out policy objective. Its only objective seems to be a short-term one of reducing rates on preference cargo, without regard to the effect of those reductions on U.S.-flag operators. Waterman does not understand why DOT so readily accepts the elimination of U.S.-flag operators. DOT not only would scrap the 1936 Act policies, it is also perfectly willing to scrap those who have followed them.

The lack of substantiating data for DOT's overall policy approach also infects the two specific proposals which are subjects of this hearing, as well as the rate proposals in R-104 and R-105. The eight new trade areas which are proposed have no relationship to any specific carriers' operating patterns or needs for "flexibility." The proposal relies on a general study which was commissioned, not specifically to support this proposal, but as a generalized investigation. As a result, nothing in the study supports the specific trade areas which are proposed. However, the Trade Route Redesignation Proposal seems to contemplate the effective elimination of section 605(c).

Waterman's comments on the Trade Route Redesignation Proposal included a detailed analysis of what that redesignation would accomplish. Waterman's conclusion was that it would accompolish very little except possibly the avoidance of section 605(c) procedures in a few instances to allow a few operators to compete with other U.S.-flag operators without hearing procedures.

The proposal to eliminate G.O. 80 restrictions on "nonsubsidized voyages" by subsidized operators in MarAd Docket R-100 contains a basic misnomer: "nonsubsidized" is inaccurate, in that any voyage by an operator who receives financial aid is more competitive because of those payments, regardless of whether those payments are calculated on the basis of all or less than all of his voyages. Therefore, a subsidized operator is being subsidized to compete with another U.S.-flag operator even when he uses ships which are not named in his subsidy contract. Again, the basic tenet of the 1936 Act that subsidy money should not be used to foster competition between U.S.-flag operators is violated if MarAd does not exercise oversight over "nonsubsidized" operations to prevent that result.

MarAd's response to a Freedom of Information Act request seeking MarAd's support for the statements of reasons for the proposal showed there was none. This proposal is but another unsupported link in the chain of DOT actions blindly eliminating the protections under the 1936 Act.

The Liner Development Act of 1986, S.2662, like the DOT deregulation program, has been developed without analysis of its affect upon various operators or the necessity of the financial aid it would give to other operators. The bill carries an implicit assumption that the available subsidy monies should be paid primarily to those operating larger fleets currently, giving them subsidy for as many ships as possible.

On the other hand, the Bill purports to give certain benefits to carriers operating fewer ships at this time, but it denies a realistic opportunity for carriers such as Waterman to convert to the program. While it is somewhat difficult to decipher some aspects of the Bill and their effects on Waterman, it does not effect a forthright disposition of the issues confronting the interested carriers. One example of this is the questionable effect of the Bill's trade route "protections" on Waterman insofar as competi-

tion from another operator, such as Central Gulf. As best Waterman can determine, however, S.2662 would have the following particular effects on Waterman.

1. S.2662 withdraws benefits under Waterman's ODS contracts, including $7.5 million dollars in non-wage payments, and it effectively terminates all of Waterman's contracts by the operation of its various provisions.

2. S.2662 withdraws rights that Waterman is entitled to both under its ODS contracts and the 1936 Act itself, including: dilution of trade route protection under section 605(c); denial of protection against unfair competition by foreign-flag and "non-subsidized" vessels operated by subsidized competitors; circumvention of a final judicial determination as to the legality of U.S. Lines "unsubsidized" competition with Waterman; and, it withdraws the 3-year waiting period for foreign-built vessels to compete with Waterman for preference cargo.

3. S.2662 puts Waterman at a competitive disadvantage as against both U.S. and foreign competitors in the following respects: Waterman is entitled to payments under the new program for only 4 ships while other participants can have as many as 23 ships; an unrealistic 2-year election period is given for Waterman to amend the existing contracts and to seek authorization for additional ships; it denies Waterman the opportunity to acquire or charter fuel-cost competitive diesel-powered ships and operate them under the U.S. flag; and finally, the Bill purports to deny Waterman's existing contracts the same "entitlement" status intended to be given to contracts under the new program.

Waterman has several general areas of need in regard to a new ODS program—needs it does not believe are unreasonable and which would not harm other U.S.-flag carriers. Those general needs are, first, that Waterman be allowed to operate until the normal termination of its ODS services and changeover to a new program with the number of vessels to which it has contractural, legal entitlement. Its second need is that the protections promised by the government to Waterman in return for its accepting and fulfilling obligations to build new U.S.-built ships be honored now and in the future (as they had been until recently). This encompasses continuing the protections of section 605(c), section 804, G.O. 80 and the Cargo Preference Laws, while Waterman changes to the new program. In order to convert to the new program, Waterman seeks an opportunity to compete on an equal basis with all other carriers by being allowed to operate a fleet which is fuel-cost competitive with all flags. Waterman simply cannot understand why this would pose a problem for the rest of the industry. Surely the larger carriers are not so weak or dependent on taking Waterman's cargo that they would oppose Waterman becoming more competitive.

Pursuant to these, Waterman seeks the following specific items: that it be allowed to operate under its existing contractual obligations until normal termination; protection during that time from competition by newly subsidized operators for commercial or preference cargo without section 605(c) or G.O. 80 procedures and Congressional reaffirmation of the serious and fair application of these in accordance with historical practice; protection from foreign-flag competition by other subsidized operators without section 804 procedure—also to be reaffirmed in accordance with historical practice; that during that period there be no legislative circumvention of legal processes as to current or future section 605(c) (e.g. Lykes), section 804 or G.O. 80 (e.g. U.S. Lines) cases, whether or not currently pending; that Waterman be allowed to build or charter foreign immediately in order to become competitive; that Waterman be allowed to operate the maximum number of contractually-authorized subsidized vessels and that this number of vessels be the basis for any calculation of maximum vessels for which subsidy will be paid; that Waterman be protected from reduced cargo or notes from foreign-built competition for preference cargo without the 3-year waiting period, and that Congress reaffirm the existing legal precedents which would be violated by MarAd's proposals to deny individual U.S.-built ships a reasonable profit on preference cargo.

Waterman sees no reason why these provisions should not be included in the Bill: The Bill makes Waterman's U.S.-flag colleagues more competitive.

It should make Waterman more, not less, competitive. Like the other U.S.-flag operators, Waterman cannot survive unless it becomes competitive with foreign-built tonnage, which means Waterman must begin to operate foreign-built tonnage as soon as possible.

Waterman needs its existing contract subsidy to cover operation of U.S.-built ships during the changeover period. Loss of the $3 million annual payment for non-wage subsidy items would, under Waterman's financial projections, seriously jeopardize its financial health and ability to fulfill its reorganization plan.

Waterman needs protection from competition by subsidized operators foreign-built U.S. or foreign -flag vessels, ("subsidized" or non-subsizided") until changeover, because such competition would further lower depressed rates on both government-impelled and non-government-impelled cargoes. Competition from U.S. Lines's U.S. and foreign-flag fleet has lowered our inbound cargo tonnage and decreased the rates, thus lowering our profits per voyage. Only the luck of lower fuel costs saved us from losing $250,000 more on each 1986 voyage inbound as a result of this competition.

Waterman needs protection from competition by subsidized operators' U.S. built U.S.-flag vessels for nonpreference cargo under a seriously administered section 605(c), until changeover, because such competition would further lower depressed rates on both government-impelled and non-government- impelled cargoes. Our experience proves that another subsidized competitor results in immediate lowering of outbound rates, which would have the same seriously detrimental financial effect on Waterman.

Waterman needs protection during changeover from further subsidized vessel competition (such as Lykes or Central Gulf) because it is already carrying a dominant share in the outbound markets it serves, and new competition must take Waterman cargo—there is now no other available cargo in its markets—with the same results as above. If there is more cargo for U.S.-flag vessels, Waterman can carry it during changeover with a mixed fleet.

Waterman needs the opportunity to operate its contractually-authorized number of vessels in order to operate a fully competitive service and take advantage of hoped for increases on its routes in the volume of cargo which covers the costs of a U.S.-flag liner service. Waterman needs to have the freedom to operate a number of vessels under the new program which will be sufficient to be competitive in the trades where they operate.

Waterman needs protection from administrative deregulation and administrative cutting of preference rates during changeover, for it is obvious DOT can destroy all of Waterman's protections if it does not support them fairly and seriously.

Senator STEVENS. Thank you.

Mr. HEARN. I would like to add that we have amendments prepared which we submitted with our formal statements.

Senator STEVENS. Mr. Merrigan.

Mr. MERRIGAN. Thank you, Mr. Chairman.

I serve, Mr. Chairman, as Washington counsel to Central Gulf Lines of New Orleans, Louisiana. And I appear today in place of Mr. Eric F. Johnson, the president of Central Gulf, who is simply unable to be here because of some very long standing conflicting business commitments.

From the very outset we want to commend you, Mr. Chairman, and Senator Inouye and the other members of this Committee who recognize that the U.S. flag merchant fleet is in a state of serious decline, and that effective legislative actions must be taken immediately to reverse the disastrous trend.

I might say that in this regard we have worked constantly with the other carriers in the preparation, in the drafting and the arguments leading up to the drafting of the legislation today, and we hope and pray that the things that we are concerned about today are simply oversights in the final draft of that legislation. I have been so advised that might be the case.

Central Gulf, in sum and substance, strongly supports the basic concept involved in S. 2662 but simultaneously emphasizes that the amendments we are about to testify about are really essential or else the statute would be tremendously counterproductive in our case and very self-defeating, and would really damage Central Gulf very tremendously if it were not corrected.

We think that in the meantime, Senators, it should be obvious that until Congress enacts S. 2662 or some similar legislation which would create a level playing field for the competing U.S. flag operators—Central Gulf is a non-subsidized line—that it would be exceedingly short-sighted and destructive for the Maritime Administration to administratively eliminate General Order 80 or to consolidate the existing trade routes.

As you undoubtedly know, under current Federal Maritime law, some of the surviving U.S. flag liner operators receive operating differential subsidy payments and companies like Central Gulf and Sea-Land, of course, do not. Also under Federal Maritime law some U.S. flag liner operators have been specially licensed to build or acquire foreign liner vessels that immediately became eligible for the carriage of U.S. preference cargoes, while other competing U.S. flag liner operators, and I would have to say like Central Gulf again, have been prohibited by law from transporting preference cargoes in foreign-built reflagged vessels until those vessels have been documented under the laws of the United States for 3 years.

This problem became excruciating several years ago when, of course, the government terminated the vessel construction subsidy program. That action, coupled with spiraling costs of vessel construction in the United States shipyards, simply made it impossible for companies like Central Gulf to construct vessels—new vessels, modern vessels that it needs and wants and does want to build now—here in the United States.

From our standpoint, the basic concept contained in S. 2662 would remedy these two problems by simply substituting the level playing field that I had mentioned a minute ago for all operators in place of the extremely tilted field that presently exists, and it would do this in two ways.

First, it would mandate that the government's operating differential subsidy payments would be made available to all qualified U.S. lines, those that have it today and those that do not have it today. The bill also provides that henceforth qualified U.S. flag liner operators have the right to acquire new modern vessels and to carry preference cargoes on those vessels immediately after they are documented under the laws of the United States.

So, those are the basic concepts we fully support. S. 2662, though, is not perfect, and it really requires these changes in our opinion. section 4(2) of the bill: Central Gulf appreciates why a provision might have to be made for companies like Waterman so as to protect small subsidized operators against an influx of new unfair subsidized competition from one or more large operators on specific trade routes that are essential to the small operator.

Central Gulf, however, is also a small, but unsubsidized operator, and it, too, has a historic relationship with at least one trade route that Waterman says is its trade route. Central Gulf has operated on and off that trade route for years, and just recently when Waterman took Chapter 11 bankruptcy, it reinherited from Waterman three chartered vessels which it suddenly was confronted with operating again, so those vessels were chartered to the United States. Those charters will soon end, and there is only one place presently where those vessels can be used, and that is back on Trade Route 18 which Waterman is claiming.

Now, we would certainly go back on Trade Route 18 with those vessels unsubsidized, and we do not want this bill to prevent us from returning simply because Congress is going to put us on a level playing field with the other carriers. So, while we certainly have tremendous sympathy for Waterman, we do not want this bill to solve Waterman's problem without taking our problem into consideration, that is, by granting Waterman what would amount to a monopoly on our old trade route.

Now, under section 4(3), Senators, to operate profitably—and fortunately, Central Gulf has been one of the successful operators over the years—we have had two foreign affiliates. They are affiliates that operate bulk vessels under a foreign flag and one or two liner vessels under a foreign flag. We certainly do not want to have to destroy our present successful operations simply to become eligible to participate under this bill.

The idea is to build up the viability of the merchant marine and not to destroy what is working today. So, we are asking the Congress to have some sort of a grandfather provision or some satisfactory provision which would apply in cases such as ours where we have been unsubsidized. Central Gulf's existing arrangements have thus not been subject to section 804, and we urge that they be grandfathered so as a contractor Cental Gulf would have the right to continue to operate foreign vessels, and these old affiliates which have these historic operations would be allowed to continue.

The last suggestion we have to make, Mr. Chairman, is to section 4(4), and it is something which I think everyone agrees with, and I think it has been inadvertently left out, is that the preference cargoes which are reserved to U.S. carriers should certainly be carried by U.S. citizens that own these vessels. And by U.S. citizens we mean whether they be individuals, partnerships, or corporations.

So, section 2 of the Shipping Act should apply, we respectfully submit, to guarantee that the share of government cargoes reserved by preference to U.S. flag carriers is carried by genuinely U.S.-owned vessels.

I am simply going to summarize the last part of our statement, which echoes back everything that I think you heard from the other witnesses, which is until you can enact this statute, the Maritime Administration would destroy the current status quo by proceeding to repeal General Order 80 and by consolidating the existing trade routes. It would establish a tremendously unfair new competition for the unsubsidized car-

riers, and I think for carriers such as Waterman that are small and that are struggling to survive and turn loose suddenly on them unsubsidized operations by subsidized carriers. So we recommend, as has been almost generally agreed here, that General Order 80 should stay in existence until Congress acts, because it is really vitally important.

Thank you, Mr. Chairman.

[The statement follows:]

STATEMENT OF EDWARD L. MERRIGAN, COUNSEL, CENTRAL GULF LINES, INC.

Mr. Chairman: My name is Edward L. Merrigan. I serve as Washington counsel to Central Gulf Lines, Inc. of New Orleans, Louisiana, and I appear today in place of Mr. Erik F. Johnsen, President of Central Gulf, who is unable to testify personally because of long-standing, conflicting business commitments.

From the very outset, we want to commend you, Mr. Chairman, and the other members of this committee who recognize that the U.S. flag merchant fleet is in a state of serious decline, and that effective legislative actions must be taken immediately to reverse the present disastrous trend.

Consequently, Central Gulf strongly supports the basic concept embodied in S.2662, but simultaneously emphasizes that the bill will surely become counterproductive and self-defeating unless it is amended in the three or four vitally important respects I shall soon identify.

In the meantime, it should be obvious, we respectfully submit, that until Congress enacts S.2662 with aPpropriate amendments or some other similar legislation that guarantees the creation and maintenance of a "level playing field" for competing U.S. flag operators it would be exceedingly shortsighted and destructive for the Maritime Administration to eliminate General Order No. 80, or to endeavor to consolidate essential trade routes.

In summary, therefore, Central Gulf urges the committee favorably to report 1.2662 with amendments, and to take whatever actions are available to prevent the repeal of General Order No. 80 and consolidation of trade routes until the legislative process can be completed.

With Appropriate Amendments, S.2662 Would Clearly Be In The National Interest, And Its Early Enactment Is Essential To Creation Of A Modern. Competitive U.S. Merchant Fleet.

Under current federal maritime law, some of the surviving U.S. flag liner operators receive operating-differential subsidy payments from the government while other competing unsubsidized U.S. flag liner operators do not.

Also under federal maritime law, some U.S. flag liner operators have been specially licensed to build or acquire foreign liner vessels that were immediately eligible for the transportation of U.S. preference cargoes, while other competing U.S. flag liner operators are prohibited by law from transporting preference cargoes in foreign-built. re-flagged vessels until those vessels have. been documented under U.S. laws for a period of three years. This problem was exacerbated several years ago by termination of the federal vessel construction subsidy program and the spiraling costs of vessel construction in United States shipyards.

If enacted, the basic concept contained in S.2662 would remedy these problems by simply substituting a "level playing field" for all operators in place of the extremely tilted field on which they presently seek to compete, both with each other and with a growing array of heavily subsidized foreign competitors.

The "basic concept" of S.2662, which Central Gulf unqualifiedly supports, is really twofold as follows:

1. The bill mandates that henceforth the Government's operating-differential subsidy payments shall be available to all qualified U.S. liner operators on equal terms and conditions; and

2. The bill also provides that henceforth qualified U.S. flag liner operators shall have the right to acquire new, modern foreign vessels for operation under the U.S. flag on an equal footing, meaning that all such vessels shall be eligible to transport U.S. preference cargoes immediately after they are documented under the laws of the United States.

Like most proposed legislation, however, S.2662 is not perfect. It requires amendments to remove or. correct provisions that threaten to dilute or defeat its salutary "basic concept." Based on our preliminary review of the bill (which was not available to Central Gulf until shortly before it was released by the committee on July 17, 1986), the following amendments are critically important:

(i) Section. 4(2): Central Gulf appreciates why provision might have to be made to protect some small U.S. subsidized operators against an influx of new unfair, subsidized competition from one or more large operators on soecific. trade routes that are essential to the small operator.

Central Gulf, however, is a small unsubsidized operator and it too has a historic relationship with one or more specific trade routes that are essential to it. Yet, as presently drafted., Section 4(2) would effectively preclude Central Gulf, when it becomes subsidized under the new law, from automatically resuming these long-standing operations solely because some of its liner vessels were on charter to the United States during the period between 1982 and 1985.

In the normal course of events, the existing charters of these vessels to the United States will ultimately terminate, at which time Central Gulf must be able to resume its old trade route operations.

Consequently, if Section 4(2) is to remain in S.2662, appropriate amendments must be made to enable small operators such as Central Gulf to return to their full, historic trade route operations upon completion of existing charter arrangements with the United States.

(ii) Section 4(3): As proposed, S.2662 would make the restrictions of Section 804 of the Merchant Marine Act of 1936, as amended (46 U.S.C.1222) applicable not only to U.S. flag contractors under the new law, but to affiliates of such contractors as well. In order to prevent unnecessary, destructive interference with the operations of U.S. flag unsubsidized liner operators and affiliates of such unsubsidized operators not currently subject to Section 804, S.2662 must be amended to make Section 804 fully applicable to new U.S. contractors who become contractors for the first time under Sections 616-617 of S.2662,. but not to historic affiliates of those new contractors.

(iii) Section 4(4): Central Gulf respectfully submits that a clarifying amendment should be adopted that would require eligible preference cargo vessels to be operated by U.S. citizens, including U.S. citizen corporations as defined in Section 2 of the Shipping Act.

Until The Congress Has An Opportunity To Complete The Legislative Process And Enact S.2662 Or A Similar Bill, The Maritime Administration Must Be Prevented From Repealing General Order 80 And From Consolidating Trade Routes.

Central Gulf submits that elimination of all regulatory controls on non-subsidized voyages by subsidized liner operators at this critical moment, while Congress is endeavoring to enact legislation that will establish a "level playing field" for all U.S. flag liner operatorss would (a) be contrary to the letter, sense and purpose of the Operating Differential Subsidy provisions of the Merchant Marine Act of 1936, as amended; (b) subject unsubsidized U.S. flag carriers, as well as the weaker surviving subsidized U.S. flag operators, to new unfair, destructive economic competition from the larger subsidized U.S. flag liner companies; (c) adversely affect the ability of the United States government to assure that subsidized operators will continuously meet minimum sailing requirements under their ODS contracts, and otherwise continuously provide adequate service on their regular subsidized trade routes, and (d) seriously impact the ability of major segments of the struggling, dwindling U.S. Merchant Marine subsidized and unsubsidized operators alike to continue to provide essential U.S. flag service in an economical and efficient manner. Last but not least, of course, repeal of these historic regulatory restraints on subsidized operators at this time would literally pull the rug out from under Congress' effort to enact "level playing field" legislation such as S.2662.

Essentially, therefore, this is a totally unsupportable administrative idea which should be completely abandoned by MARAD. At the very least, however, it should be shelved until Congress enacts some form of legislation that will remove the inherent inequities and provide "a level field" for all competing U.S. flag liner operators.

Conclusion

1. S.2662 should be favorably reported, with amendments.
2. All administrative attempts to repeal General Order 80 etc. should be held in abeyance until Congress acts.

Senator STEVENS. Thank you. We look forward to looking at your suggested amendments, Mr. Hearn. We tried to deal with your company in section 4 of S. 2662. If you have additional items, we will consider them. I do not know exactly how far we can go and still keep the consensus, but we will look at your recommendations.

Mr. HEARN. Thank you, Mr. Chairman.

Senator STEVENS. I understand your point, Mr. Merrigan. You have a bona fide point that we may have to modify S. 2662 to protect your rights while we are trying to protect Waterman's. We will have to take a look at the issues you raised. I do not have any questions about your positions.

Mr. HEARN. Thank you. I would like to add one thing, if I may. Waterman, as Mr. Merrigan alluded to us, has been in chapter 11, but we filed our reorganization plan last month and it has been accepted. We have had a closing, so we are out of Chapter 11, just for the record.

Mr. MERRIGAN. By the way, our relations with Waterman, I think, are excellent.

Mr. HEARN. I am not stating that. I just did not want you to think we were still in chapter 11.

Senator STEVENS. Well, you just got there first. If we do not pass this bill, you will all be in chapter 11 together.

Senator Inouye?

Senator INOUYE. Mr. Chairman, I would like to join you in assuring Mr. Hearn and Mr. Merrigan that we would not be suggesting to our colleagues in the Senate that they support a measure that would benefit one segment at the expense of the other, and we have so indicated to big liner operators, and we have received assurances from all of them that they would not be only pleased, but they want very much to sit with both of you to work out some sort of arrangement whereby your concerns can be adequately addressed, and with one caveat, we would like to have you do it yesterday.

So, if I can suggest to you that you begin the process at lunch, which we hope will commence in about half an hour, it is that serious for us. I have looked over some of your suggestions, and from where I sit I am certain some of the bigger companies may feel a bit unhappy, but I do not see any damage being done to them. I am certain something workable can be agreed upon.

So, you have the assurances of the big people, you have the assurances of the two of us here that we are not going to let you go under.

Mr. HEARN. Thank you very much, Senator. We will continue to make every effort, as we have in the past, and we certainly appreciate on behalf of the company your remarks.

Senator STEVENS. That does not mean we necessarily agree with you yet.

Mr. HEARN. Yes, I understand that, Mr. Chairman.

Senator STEVENS. There is still some negotiating to be done here, and I am sure you agree with that.

Senator INOUYE. Absolutely.

Senator STEVENS. Thank you very much, gentlemen. We look forward to working with you.

Our last panel is Mr. Mills, counsel for Crowley Maritime, Mr. Anderson, associate general counsel for Matson Navigation Company, and Mr. Butchman, counsel representing Totem Ocean Trailer Express. So that those who are here might know what I propose before this panel starts, let me state that we reported the MarAd authorization bill, H.R. 4175 from Committee. I propose to try to get cooperation from the Committee and from the leadership to offer S. 2662 as an amendment to H.R. 4175, if we can get this bill to the point where we can report it. We will need an understanding with our friends from the House to go to conference on this bill almost immediately. We can determine whether or not we can obtain a consensus that will meet the approval of the industry in conference, and at the same time address the problem of the budget.

The effective date of S. 2662 will have to be changed to October 1, 1987, but let me assure everyone that that is just for the purpose of getting it through the Senate floor to conference. The final effective date and the costs of the reform package will have to be worked out in conference.

This is just a tactic to avoid a point of order relating to the Budget resolution. I have a letter addressed to the Chairman and ranking member of the Budget Committee to ask their understanding and to allow us to go to conference. We will pledge not to avoid the budget consequences of the bill when it comes out of conference, if we can get out of conference. If we are allowed to go to conference quickly, I think that we might be able to pass this legislation soon. I intend to join with Senator Inouye in asking the administration, particularly Mr. Gaughan, to defer to us for a reasonable period to see if we can get the reform package passed. To me, that reasonable period means at least until the end of September. I think it can be passed, and I think that we are very close now to what Senator Inouye refers to as, an understanding. We do have a general consensus. There are some issues that must be worked out, not the least of which is an agency downtown called the Office of Management and Budget. It will not do us any good to pass a bill which does not meet the approval of the President.

There is just no reason to send him a bill that is going to be vetoed. We might as well just defer to MarAd and let the administrative proceedings go ahead. I think we can work it out. It is going to take a lot of effort, and it is going to take some give and take before we are through. And so my good friend and I are prepared to continue that process. It will take a little bit of trust from the industry to understand what we are doing, because there are some people who have already said they do not like that October 1, 1987 effective date. I hope everybody understands this approach is the only way the bill is going to get to conference in a hurry.

If we cannot get approval of that process, we will have to solve the budget problems before we even get the bill passed by the Senate. We will get the budget problem solved a lot faster if we can assure the administration that we do have an agreement not only between this committee and the industry, but also among the conferees. This will give us a bill that both the House and Senate can look at in a budgetary context.

Currently, that is not possible. We do not have that agreement yet. You cannot cost this bill out until we aget it, and I think we have to have that total agreement which is acceptable to the President.

Do you wish to comment, Senator Inouye?

Senator INOUYE. I wish to associate myself with your remarks. That means I agree with you 1,000 percent.

Senator STEVENS. In 18 years I cannot remember an argument we have had, so I am delighted. And should calamity from my point of view but success from your point of view prevail, I am sure it would be the same way around.

Our next panel will lead of with Mr. Mills. Would you be first, please?

STATEMENT OF THOMAS L. MILLS ON BEHALF OF CROWLEY MARITIME CORPORATION

Mr. MILLS. Thank you, Mr. Chairman. And Crowley certainly understands that.

Mr. Chairman, although it is a pleasure to be here and an honor, the truth be known, Crowley would just as soon not be participating here. This bill tackles very much needed subsidy reform and Crowley is supportive of the effort. It is not subsidized, it does not intend to be subsidized, and would just as soon stay on this side of the process.

We have some concerns, however, insofar as this bill would impact upon the interface with the subsidized operations and the domestic trade. Mixed service is the first and the greatest concern, mixed service being, as I would define it, where a subsidized vessel on part of a subsidized voyage in the foreign trade lifts cargo at a domestic port of origin and discharges it at a domestic port of discharge.

For example, Hawaii on the way to the Far East, perhaps Alaska in some other service. The law on mixed service, Mr. Chairman, is set down in a case with Mr. Anderson's company called Matson v. Conner in 1969. In that case, there was the application under section 805(a) for a subsidized carrier to stop at Hawaii on the way to a foreign voyage.

Matson prevailed in showing there that there was no way under the existing scheme to cleanse the vessel insofar as the domestic cargo was concerned of the subsidy, and there came to be known, the term was used, residual subsidy benefit inured to the subsidized operator.

Nevertheless, the Secretary of Commerce at that point granted the permission, and he granted the permission because he found that the residual subsidy benefit did not result in a substantial competitive advantage. That case was affirmed by the courts, and the reason that the substantial competitive advantage was not found to flow from the sub-

sidy benefit was in part—and this is right from the court case and the Secretary of Commerce's decision—that there were offsetting advantages to the domestic carrier by virtue of the contractual and statutory restrictions which the subsidized carriers were subjected to.

And that gets us to this bill. In this bill, Mr. Chairman, the statutory contractual restrictions to which in that case the subsidized carrier was subjected to will largely disappear. There is complete trade deregulation, dramatically relaxed 804 restrictions, payment of subsidy on a more current basis, foreign build and reflagging capabilities, et cetera.

In that case, first of all, I think it is fair to say Crowley did not agree with the conclusion in the first place. But at any rate, this changes that competitive environment, this changes the basis upon which that decision was reached, and we think there is no reason for there to continue mixed service if this bill continues forward, and from a fairness standpoint I think that conclusion follows.

And given that this bill has to do with subsidy reform and the subsidy is intended for the foreign trade, Crowley's position is simply let us keep the subsidy in the foreign trade, and I think good things will flow from that.

Insofar—we have somewhat of a concern, although again there will be give and take on this, and that has to do with grandfathering in the existing 805(a) provisions, again because of the dramatically changed competitive environment.

There are things which and restrictions which applied when the permissions were given which will no longer apply. We have not fully evaluated all of that, but we are concerned with just a blanket approval and grandfathering of existing permissions.

We are also concerned about grandfathering, if that term is correct in this case, service which is not the same service that has occurred before, but which in fact is dramatically increased service, which has never undergone the rigors of an 805(a) hearing.

Beyond that, we have just one clarifying suggestion with respect to preference cargo, and that completes my summary.

Senator STEVENS. Thank you very much.

Would you look at your statement at the bottom of page 4 and tell me if I am reading it wrong? Do you see that part where it says, "In fact, the rule has developed in the case law"?

Mr. MILLS. There is a dropped line.

Senator STEVENS. Would you provide that for us?

Mr. MILLS. Absolutely. I apologize.

Senator INOUYE. That just shows we read these things.

Mr. MILLS. I am delighted. We did that on purpose, of course.

Senator STEVENS. I passed the test, then.

[The statement follows:]

STATEMENT OF THOMAS L. MILLS, ON BEHALF OF CROWLEY MARITIME CORP.

I am Thomas L. Mills of Dyer, Ellis, Joseph & Mills. This statement is submitted on behalf of Crowley Maritime Corporation. Crowley Maritime Corporation is a large tug and barge company that provides common carrier transportation service between the mainland United States and Alaska, Hawaii and Puerto Rico and contract tug and

barge service throughout the world. Crowley owns or operates 400 vessels; none of the vessels Crowley operates receives ODS.

We have reviewed the provisions of S.2662, the Liner Development Act of 1986, from the point of view of Crowley's exclusively domestic operations. As you know, Mr. Chairman, Crowley Maritime has operated in unsubsidized domestic services for many years with the exception of the 2-year period during which Crowley operated Delta Steamship Lines. From that point of view we have concerned ourselves with the interface between the subsidized carriers and the domestic trade and will generally limit our testimony to those aspects of the bill.

Mr. Chairman, the regulation of subsidized carriers conducting domestic operations is contained in Sections 605(a) and 805(a) of the Merchant Marine Act, 1936. Section 620(c) of S.2662 would grandfather the existing domestic operations and the planned additional domestic operations of the presently-unsubsidized operators who would become subsidized under the Liner Development Act. It would also continue in effect the present domestic operations or, more precisely, "domestic liner services . . . in substantial accord with [1985] services" or services "which had express approval during calendar year 1985." In short, I believe the liner company proponents of S.2662 have characterized their treatment of the Section 805(a) issue as a "snapshot" treatment; that is taking a "snapshot" of the domestic operations of all the companies which would now be or would continue to be, subsidized under the Liner Development Act and continue those operations unabated. Unfortunately, as Crowley sees it, that is the only thing which remains the same: Trade route regulation is gone; restrictions on foreign-flag affiliation and feeder services are nearly gone; "subsidy reform," as was previously part of the dialogue, has been abandoned altogether in favor of merely adding new companies on subsidies at full-wage parity, without any cap on the amount of subsidies that are to be paid.

Insofar as domestic operations are concerned, Crowley is faced with potential supercompetitors created under this Act. Crowley presently competes with U.S. Lines in the West Coast/ Hawaii trade and with Sea-Land in the Puerto Rican and Alaskan trades. Sea Land would be immediately eligible for its domestic services without ever having undergone the hearing requirements of Section 805(a) which forms the basis for protection of domestic operators under the 1936 Act. In fact, as to Sea-Land's Alaska service, its new buildings would be "grandfathered" despite the fact that those new buildings are not yet in the trade, would represent a 50% increase in Sea-Land's capacity in the trade, and a 25% increase in the total trade capacity, all at a time when the trade is seriously overtonnaged and the rates are below cost. Moreover, Sea-Land, never having been subsi- dized, has not had to structure its company or financial accounting in such a manner as to insure segregation of subsidized and unsubsidized operations.

In addition, API, and U.S. Lines would be allowed to keep their previous \$805(a) approvals without any further hearing requirement, despite the fact that the method of payment of subsidy, the foreign-flag affiliation restriction and trade route deregulation which were extant at the time that those \$805(a) permissions were given, have been eliminated or changed. In short, the competitive environment will have changed dramatically in favor of the subsidized operators. Crowley must, therefore, oppose the grandfathering of any existing domestic services, or permissions for domestic services without the requirement for a Section 805(a) hearing.

Crowley's position is that "mixed services", i.e., the services detailed in Section 605(a) of the 1936 Act, should be prohibited altogether. Under S.2662, they would be permitted within the existing Section 805(a) regime. By way of background, Section 805(a) permits, with the permission of the Maritime Administration after a hearing afforded to exclusive- domestic operators, domestic operations by otherwise subsidized operations. The standards are that no unfair competition with exclusively domestic operators should be permitted, and the grant of permission should further the purpose and policy of the Act. The cases have evolved into two distinct scenarios—affiliation cases and mixed service cases. Affiliation cases are those in which an affiliate of a subsidized operator would operate a separate unsubsidized ship in a separate unsubsidized service. Generally, the constraints of Section 805(a) have led to separate incorporation of the unsubsidized vessel operator with separate accounting and controls, keeping the subsidized and unsubsidized operations completely separate, so that no subsidy benefits can flow to the domestic operation.

The "mixed service" cases are completely different. There, a subsidized vessel on a subsidized voyage in the foreign trade also lifts cargo at a domestic port of origin and discharges it at another domestic port as part of the foreign voyage. U.S. Lines' service to Hawaii from the U.S. West Coast as part of its Far East service is a classic example of such a service. It has been established through the history of the administration of Section 805(a) that there is no real way to segregate the subsidy benefit on the foreign-bound cargo from the domestic cargo despite the abatement of ODS provided in Section 605(a) and of CDS provided in Section 506. Both require abatement on a gross revenue basis, i.e., so much of the ODS and CDS for the voyage as the gross revenue from the domestic cargo bears to the gross revenue from the entire voyage. In fact, the rule has developed in the case law that, unless the domestic operator can prove that there is "substantial subsidy benefit," the Section 805(a) permission for mixed service by the subsidized operator will be granted. Conversely, it is admitted—and has come to be accepted—that the subsidized operator will enjoy some subsidy benefit in the domestic trade. Crowley believes this is unfair. Perhaps in the context of what has heretofore been the high entry and administrative cost of doing business in the subsidized foreign trade, some added benefit in the domestic trade might have been viewed as acceptable. However, in the context of continued full wage subsidy parity, and otherwise complete deregulation, we think there is no good reason for a subsidized carrier to be operating in the domestic trade, much less to be operating in the domestic trade with a subsidy benefit which ought to be cloistered exclusively in the foreign trade.

Mr. Chairman, Crowley is fully aware of the dire straits through which the subsidized American liners have been sailing. Crowley is not here trying to better its lot. While the Crowley organization is itself opposed to the concept of subsidy, it does not oppose this legislation. On the contrary, it is supportive of the effort put together by the liner proponents of this bill and organized labor. Crowley cannot, however, support any effort to increase subsidy or subsidy benefit to companies who would use that benefit to compete with it in the domestic trade where Crowley has no subsidy. We would be happy to work with the Committee staff and with representatives of the liner companies and labor in crafting new language which would insure that the subsidy benefits intended to support our American-flag fleet are kept in the foreign trade where they are intended.

With respect to the carriage of preference cargoes, the Liner Act amends \$901(b)(1) of the 1936 Act to provide that a "qualified vessel" is eligible to carry preference cargo. A qualified vessel is defined in \$625(1) to mean:

> a liner vessel wherever built (a) constructed of steel or other acceptable metal, (b) self-propelled by steam or motor, (c) as nearly fireproof as practicable, (d) over five thousand deadweight tons, (e) less than twenty-five years of age by reference to the vessel's most recent documentation, unless the Secretary finds or has found pursuant to this Title that it is in the public interest to grant operating-differential subsidy payments for the operation of such vessel, and (f) documented under the laws of the United States.

It is clear, therefore, that existing foreign-built vessels will be immediately eligible to carry preference cargoes. Crowley, and the Berger Group with which Crowley owns five new Panamax bulk vessels, have long supported immediate eligibility for new buildings as was permitted under Section 615. Crowley is opposed, however, to immediate eligibility with respect to reflagged vessels unless it is limited to liner-type cargoes.

Thank you, Mr. Chairman. That concludes my statement. I would be pleased to answer any questions.

Senator STEVENS. Mr. Anderson, please.

STATEMENT OF DAVID F. ANDERSON, ASSOCIATE GENERAL COUNSEL, MATSON NAVIGATION COMPANY, INC.

Mr. ANDERSON. Mr. Chairman and members of the subcommittee:

On behalf of Matson, thank you very much for this opportunity to express our views. As an unsubsidized company, our interest here is limited to section 805(a) of the Merchant Marine Act. We would be recommending the change which we are proposing in 805(a) whether or not this bill were pending.

We feel that change is overdue and needed even under present law, but that this bill does significantly enhance the need. Some of the reasons were expressed by Mr. Mills. The bill certainly will, if it goes through, bring new lines under subsidy. It will make the subsidized operators financially stronger, with much more flexible operations, and will increase the possibility that they will seek to come into the domestic trades, with possible impairment of existing exclusively domestic services. That is our concern.

We feel that section 805(a) should be strengthened so that impairment of existing domestic services would have to be considered by the Maritime Administration and the Department of Transportation before any new 805(a) permissions are granted.

Matson has no problem with the bill as it stands as to grandfathering in existing operators. We do think that it is important that the section be strengthened in the future, however.

That concludes my statement. Thank you.

[The statement follows:]

STATEMENT OF DAVID F. ANDERSON ASSOCIATE GENERAL COUNSEL, MATSON NAVIGATION COMPANY, INC.

Mr. Chairman and Members of the Subcommittee, I am David F. Anderson, Associate General Counsel of Matson Navigation Company, Inc.. Thank you for this opportunity to discuss the future of the operating-differential subsidy program as it impacts on Matson. Matson's concern is in strengthening the provisions of Section 805(a) of the Merchant Marine Act, 1936 to prevent operating-differential subsidy contractors or their affiliates from operating in the domestic trades when it would impair exclusively domestic services. Section 805(a) has been rendered almost meaningless by recent agency and court decisions.

Section 3 of the draft bill under consideration would make changes to Section 805(a) by means of provisions in a new Section 620(c) of the Act. Matson has no objection to the draft bill provisions to "grandfather in" domestic operations in existence in 1985, and to permit replacement of old vessels by vessels under construction in the United States prior to January 1, 1986. Any additional domestic liner services, however, should be permitted only pursuant to a strengthened Section 805(a).

The substantive provisions of Section 805(a) have remained unchanged since the inception of the Merchant Marine Act in 1936. They render it unlawful for the Secretary of Transportation to pay operating-differential subsidy to contractors if they or their corporate or individual affiliates own, operate or charter, or have any pecuniary interest in, vessels engaged in domestic intercoastal or coastwise service, without the written permission of the Secretary. The statute requires denial of applications for written permission if the Secretary finds that approval will result in "unfair competition to any person, form or corporation operating exclusively in the coastwise or intercoastal service" or that it would be "prejudicial to the objects and policy" of the Act.

Section 805(a) also provides that it shall be unlawful for any subsidy contractor or affiliate to divert, directly or indirectly, any moneys, property, or other thing of value, used in foreign trade operations, for which a subsidy is paid, into any coastwise or intercoastal operations.

Matson has an exclusively domestic liner service in the carriage of cargo between ports on the U.S. Pacific Coast and ports of the State of Hawaii. Other operators have exclusively domestic liner services in the Hawaii, Alaska and Puerto Rico trades. All face the threat of competition by operating-differential subsidy contractors or their affiliates which is potentially unfair or prejudicial to the objects and policy of the Merchant Marine Act. Since the 1970 amendments to the Merchant Marine Act extended operating-differential subsidy to bulk carriers, exclusively domestic liquid or dry bulk carriers face the same threat. Matson's President, Michael S. Wasacz, recently represented the Jones Act liner operators as a member of the Congressional Maritime Caucus Advisory Board. The unsubsidized Jones Act liner operators group was unanimous in recommending to the Maritime Caucus Chairman Walter Jones that Section 805(a) be strengthened.

The need to strengthen and clarify Section 805(a) is largely the result of a December 1984 decision of the Secretary of Transportation in Docket No. S-724, Aeron Marine Shipping Company, et al. That decision rendered Section 805(a) virtually meaningless by holding that:

(1) There can be no "unfair competition" in the absence of diversion of subsidy funds to the domestic trades.

(2) It is not necessary for operating subsidy applicants to disclose the nature and scope of oPerations they propose to conduct in the domestic trades, or even which domestic trade or trades will be served.

(3) Once operating subsidy applicants have shown that there will be no diversion of subsidy funds, the burden shifts to the protestants to establish prejudice to the objects and policy of the Act.

(4) Adverse impact on exclusively domestic operators of the entry of operating-differential subsidy contractors or their affiliates is irrelevant. The only relevant consideration is the long range impact on the level of service in the trade in question.

The decision of the Secretary of Transportation was upheld by the United States District Court for the District of Columbia and is now under appeal to the United States Court of Appeals (Nos. 85-5927 and 85-6004).

As previously mentioned, Section 805(a) specifically Provides that it shall be unlawful for any operating-differential subsidy contractor or affiliate to divert any money or other thing of value used to support foreign trade oPerations, for which a subsidy is paid, into the coastwise or intercoastal trades. The logical interpretation of the Section 805(a) requirement that applications for written permission be denied if the Secretary finds that approval will result in "unfair competition" is that "unfair competition" means something other than diversion of subsidy funds to domestic trades. There is no need to declare "unfair" that which has already been declared unlawful. The Secretary's decision in Aeron Shipping Company, therefore, effectively repeals Section 805(a)'s prohibition against "unfair competition" by limiting it to unlawful diversion of operating-differential subsidy funds into the domestic trades.

The present policy of the Maritime Administration/Maritime Subsidy Board to accept blanket applications for service in any and all domestic trades without requiring disclosure of even a general plan of operation, makes it impossible for a protesting domestic carrier to sustain its burden of proof to establish that this future unspecified activity will cause unfair competition or prejudice to the objects and policies of the Act. Without having some idea of the proposed domestic operations, it is impossible for a protestant to assess or prepare a showing of the extent to which its ability to continue operations will be impaired. Yet, even if an unsubsidized protestant could sustain its burden in proving that it would be driven out of business or forced to curtail service, that would not be sufficient to establish prejudice to the objects and policy of the Act under the Secretary's decision. Under Aeron Shipping Company, the Secretary requires protestants to prove that entry by an operating-differential subsidy contractor or its affiliate into the domestic trades will have a long-term adverse impact on the availability of shipping services in the trade. That is an impossible burden of proof because it involves long-range forecasting of the actions of other parties.

Incursions into the domestic trades by operating-differential subsidy contractors or their affiliates which have an adverse impact on existing exclusively domestic services should be considered unfair and prejudicial to the objects and policy of the Act.

To renew the vitality of Section 805(a), and to foster its purpose in preventing impairment of exclusively domestic services, the draft bill should be amended by renumbering the present Section 5 as Section 6, and inserting a new Section 5 as follows:

SEC 5. Section 805(a) of the Merchant Marine Act, 1936 (46 U.S.C. Section 1223(a)) is hereby amended by striking the colon preceding the proviso, substituting a period and adding:

"Applications for written permission shall be required to disclose the nature and scope of operations proposed to be conducted in domestic intercoastal or coastwise service. The Secretary of Transportation shall consider the impact of a grant of written permission on the operations of existing exclusively domestic services, and shall disapprove applications if approval would be likely to impair the ability of existinq exclusively domestic services to continue adequate levels of service to smaller ports or would otherwise have a significant adverse impact on existing exclusively domestic services.

Thank you for your consideration of our views.

Senator STEVENS. Thank you very much.

Mr. Butchman.

STATEMENT OF ALAN A. BUTCHMAN ON BEHALF OF TOTEM OCEAN TRAILER EXPRESS, INC.

Mr. BUTHCHMAN. Yes, Mr. Chairman. I am Alan Butchman and I will testify on behalf of TOTE. I have a prepared statement to enter into the record which I will briefly summarize.

As you know, TOTE is an unsubsidized carrier operating two U.S.-built and flagged RORO vessels between Puget Sound and Alaska. We have some problems with section 620(c) of S. 2662, which would grandfather into the Alaska trade without an 805(a) hearing three vessels currently under construction by an unsubsidized carrier, which would become subsidized under the bill.

If enacted this would be the first time that a subsidized carrier would be permitted to compete with unsubsidized domestic carriers without an opportunity for a prior hearing to determine the fairness of such service. The effect of the proposed grandfathering would be to increase the capacity in the trade by about 25 percent when the trade already has a significant amount of unused capacity.

The carrier which would benefit from this grandfathering currently operates an integrated economic enterprise, and as such each division would benefit from the resources of the entire business. Therefore, if there is to be any grandfathering as provided in the proviso to 620(c) there must be protection against subsidy leakage from foreign to domestic operations.

TOTE has had some experience with this issue during the last year because it considered acquiring a substantial interest in a subsidized carrier. We believe this experience could provide some guidance for the committee. In that instance, Totem Resources Corp., TOTE's parent, volunteered to separate the operation and management of subsidized and unsubsidized services and establish separate corporations to operate the subsidized and unsubsidized services.

It is interesting to note that the same company which is seeking to be grandfathered under this legislation intervened before the Maritime Administration in this particular example and urged that the above-referenced protections were insufficient. It asked that any further actions taken to change domestic service assets and service profile should be subject to an 805(a) proceeding.

We therefore see no valid basis upon which this company should object to the requirement for an 805(a) hearing prior to introducing these vessels into the trade.

A final comment. If the Congress, however, elects to grandfather these vessels without the safeguards of a prior 805(a) hearing, then at a minimum it should establish the right for any domestic carrier in the trade to petition MarAd to conduct an 805(a) hearing on the company's then current operations, in order that there be a forum for raising the issue of whether the subsidy is benefiting the domestic operation.

I thank you very much.

[The statement follows]

STATEMENT OF ALAN A. BUTCHMAN ON BEHALF OF TOTEM OCEAN TRAILER EXPRESS, INC.

Mr. Chairman and members of the Subcommittee, I appreciate the opportunity to appear before you today in order to submit TOTE's views on S. 2662.

While recognizing the need for legislation in this area, I will limit my comments to TOTE's concerns about the impact of the proviso found in Subsection (c) of Section 620. This proviso provides for the grandfathering of certain vessels and for the first time in history would allow a subsidized domestic carrier to compete with unsubsidized domestic carriers without an opportunity for a prior hearing to determine if such service would be unfair competition or prejudicial to the objects and policy of the Merchant Marine Act of 1936. We believe that allowing a subsidized carrier to increase its capacity dramatically in the Alaska trade, at a time when that trade is already depressed and suffering from overcapacity, would be a poor use of the taxpayers' subsidy dollars.

TOTE's Role in Alaska

I would like to briefly describe TOTE and what it, shippers, and the people of Alaska have to lose if the law is changed to allow a subsidized carrier to enter the Alaska trade. TOTE is an unsubsidized carrier operating two U.S. built, U.S. flag vessels in the trade between the Pacific Northwest and Alaska. As such, TOTE is precisely the type of carrier "operating exclusively in the coastwise or intercoastal service" that Section 805(a) was intended to protect from unfair competition by subsidized carriers.

TOTE has invested substantial private capital at significant risk in order to provide high quality transportation for Alaskans. TOTE did not earn a profit in its first five years of operation. TOTE's vessels fly the U.S. flag and are U.S. crewed. They were constructed in a U.S. yard without the benefit of construction differential subsidy, and are operated without the benefit of operating differential subsidy.

TOTE's investment in the Alaska and Puget Sound economies has created 320 new jobs of which 64 are sea-going labor, 162 are employees in the State of Washington, and 92 are employees in the State of Alaska. Additionally, 100 trucking employees (working for separate independent motor carriers) are dedicated exclusively to picking up and delivering our cargo in the lower 48 states and Alaska.

Effect of Grandfathering

The proviso to Subsection (c) of Section 620 of S. 2662 is clearly intended to grandfather the three vessels which Sea-Land is currently building for the Alaska trade. Those vessels will increase Sea-Land's capacity by nearly 50% and will increase the overall capacity in the Alaska trade (all of which is now U.S. built and unsubsidized) by approximately 25%.

The Alaska trade is already seriously depressed and overtonnaged. This past February, one carrier in the trade filed for reorganization under Chapter 11 of the Bankruptcy Code, and the Maritime Administration has paid out $75-85 million to satisfy its loan guarantee obligations under Title XI on behalf of that carrier. The Alaska economy has suffered from the decline in world oil prices. The decline in oil prices means a decline in Alaska state revenue and hence in state spending on government employment and capital construction projects. As a result, Alaskan economists have predicted that employment in Alaska could decline by as much as 5%.

It makes no sense to subsidize an increase in capacity in such a market. It is particularly frustrating for TOTE which has operated without subsidy for ten years to see federal tax dollars flow to a competitor which could use them to compete against TOTE in the Alaska trade.

We realize Sea-Land's operations in Alaska would nominally be unsubsidized. But it also appears that those operations would be integrated into a single unified economic enterprise, where each division benefits from the resources of the entire enterprise. Under S. 2662, those resources would include government subsidy funds.

TOTE's Suggested Approach

If Congress elects to grandfather Sea-Land's three vessels under construction, the critical issue is to do so in ways that ensure there will be no subsidy leakage from Sea-Land's foreign operations into its domestic operations.

Last fall TOTE's parent corporation, Totem Resources Corporation ("TRC") proposed to acquire an interest in Lykes (MARAD Docket No. S-782). Hence we have had recent experience with the conditions necessary to protect against subsidy leakage. We believe that this experience should provide guidance as to what are appropriate conditions on domestic operations by a carrier receiving subsidy for its foreign operations.

In order to ensure there will be no subsidy leakage, we believe the legislation should make any grandfathering subject to, at a minimum, the following conditions which TRC was willing to assume voluntarily in the Lykes proceeding: (a) separate operation and management of Sea-Land's subsidized and unsubsidized services; (b) separate corporations to operate the subsidized and unsubsidized services; and (c) an explicit agreement that subsidy funds will not be diverted or passed on to the domestic operations of Sea-Land, nor will such funds benefit vessels which Sea-Land operates in the domestic trades.

In addition, inasmuch as Sea-Land found these conditions insufficient in connection with TRC's proposed acquisition of an interest in Lykes, Sea-Land will surely agree that the legislation should include provisions like those Sea-Land suggested in MARAD Docket No. S-782. Thus the legislation should limit any grandfathering to Sea-Land's currently operating vessels and should include the additional provisions which Sea-Land requested in Docket No. S-782, including a requirement that any further actions taken by Sea-Land that "change [its] domestic service assets and service profile would be the subject to [sic] further notice under Section 805(a)". (Comments of Sea-Land Service, Inc. dated December 11, 1985 in MARAD Docket No. S-782, Lykes Bros. Steamship Co., Inc., Totem Resources Corp., at page 3.)

Moreover, additional conditions may also be necessary or appropriate to prevent subsidy leakage. Accordingly, the legislation should direct MARAD to conduct an 805(a) hearing to determine what additional conditions should be required so that Sea-Land may continue its current operations without risk of subsidy leakage.

Finally, if Congress elects to grandfather Sea-Land's new vessels without the safeguards discussed above, at a minimum, TOTE or any other domestic operator should have the right at any time to petition MARAD to conduct an 805(a) hearing on Sea-Land's then-current operations. This is a matter of elemental fairness. Never before has a subsidized carrier been allowed to conduct domestic operations without a prior 805(a) hearing. If Congress elects to dispense with the prior hearing, it should, at a minimum, allow unsubsidized operators to obtain a subsequent hearing. Those operators, at a minimum, are entitled to petition MARAD and have an opportunity to show that—regardless of the form through which Sea-Land conducts its international and domestic operations—the benefits of Sea-Land's subsidy for international service are inuring to the advantage of Sea-Land's domestic service and that as a result, Sea-Land's operations constitute unfair competition or are prejudicial to the objects and policy of the 1936 Act.

I thank you for this opportunity to present TOTE's views. I would be pleased to answer any questions.

Senator STEVENS. Have you read Mr. Anderson's suggested revision to 805(a)?

Mr. BUTCHMAN. I have not read it, Senator. Does that have prospective application, Dave?

Mr. ANDERSON. Yes, it would.

Senator STEVENS. Let me read it to you just to be sure I understand where you are headed. He says he wants to substitute a period for the colon in the proviso in 805(a) and add this. It is an addition. Nothing is deleted, as I understand the recommendation:

"Applications for written permission shall be required to disclose the nature and scope of the operations proposed to be conducted in domestic, intercoastal, or coastwise service. The Secretary of Transportation shall consider the impact of a grant of written permission on the operations of existing exclusively domestic services and shall disapprove applications if approval would be likely to impair the ability of existing exclusively domestic services to continue adequate levels of service to smaller ports or would otherwise have a significant adverse impact on existing exclusively domestic services."

Is that your point, too?

Mr. BUTCHMAN. Our problem is that these vessels, sir, were started when this was an unsubsidized carrier expecting to come into the trade, and now this carrier will become a subsidized carrier. This will be the first time in the history of the '36 Act that vessels such as these would be put into a trade without the opportunity for an 805 hearing.

Senator STEVENS. You are an existing exclusively domestic service, are you not?

Mr. BUTCHMAN. Yes, Senator.

Senator STEVENS. I would invite your attention to that proposed amendment.

Senator Inouye.

Senator INOUYE. Well, I gather that all of you are in agreement that 805(a) should be strengthened to protect your present status, is that correct?

Mr. ANDERSON. That certainly is correct as far as Matson is concerned.

Mr. MILLS. Correct, sir.

Mr. BUTCHMAN. Correct, Senator.

Senator INOUYE. You want them to keep their cotton-picking hands off you.

Mr. MILLS. That is right.

Senator INOUYE. I have no further questions.

Senator STEVENS. We understand the problems. It is another one of those items that has to be solved before we can get the bill passed. I am not sure that I can endorse entirely what your language says, Mr. Anderson, but I understand your point.

I think you will find, Mr. Butchman, that Mr. Anderson is going the same direction you are.

I have no further questions, gentlemen. I do understand your points, and I hope that those who have questions that are addressed to them will answer them as soon as possible.

As I explained to someone previously in a conference in my office, we all know that at this stage of the Congress a bill such as S. 2662 is not going to be enacted unless there is substantial agreement and not just consensus, as Senator Inouye indicates. That is going to take some time.

I do not have any illusions that we are close, but I think we could obtain substantial agreement if all the interests represented in this room are willing to try and are willing to really consider the other entities' point of view. I do not think it is even worth our time to try to settle the matter with OMB until we have an agreement with the industry that can be approved by the Congress.

We look forward to working with all of you. This ends this hearing.

Thank you very much.

[Whereupon, at 12:30 p.m., the subcommittee was adjourned.]

ADDITIONAL ARTICLES, LETTERS, AND STATEMENTS

STATEMENT OF C.E. DEFRIES, PRESIDENT, NATIONAL MARINE ENGINEERS BENEFICIAL ASSOCIATION

Mr. Chairman and members of the Subcommittee, I appreciate your invitation to testify on S. 2662 and other matters relating to the reform of the operating-differential subsidy program (ODS). While unavoidable conflicts in scheduling prevented me from appearing in person at the hearing, I trust the Subcommittee will accept this statement for the record.

The NMEBA believes there is no more important matter facing our industry this Congress than a national rededication of the principles embodied in the Merchant Marine Act of 1936.

The Merchant Marine Act set a positive course for the United States to develop and maintain a privately-owned merchant marine, composed of the best and safest vessels, and manned by highly trained American crews. These goals remain just as appropriate today as they were 50 years ago. What has changed, however, is the means to achieve these goals. Our industry, like most others, is not static. In the past 50 years we have nurtured a revolution in ocean transportation, and our business today is vastly different from that which existed in 1936. If we are to continue as a nation to carry out the mandates articulated in the 1936 Act, then we must inevitably address changes in the law that mirror these changes in the industry.

Since 1981, our industry experienced several false starts on the road to change. I would include in this group the ending of construction-differential subsidies and the temporary authority to build and acquire ships from foreign sources. The bill before the Subcommittee is a radical alteration of current law, and represents a substantial effort at comprehensive change. We believe it is an appropriate first step toward modernizing and rationalizing the joint efforts of the United States government and the privately-owned maritime industry to reflect the state of the industry today, and to guide its preservation and growth for the future. While we generally endorse this bill, we do have several significant concerns about certain of its provisions, and these concerns are more fully discussed later in this statement.

I should emphasize at the outset that the legislative changes embodied in S. 2662 represent principally the efforts of the corporate elements of the maritime industry. Maritime labor, and the NMEBA in particular, have played only a small role in the development of this legislation. Yet our stake in the outcome of this bill is great. I can assure this Subcommittee that the NMEBA will work with it and all other interested participants in the most constructive manner possible to ensure the best outcome for the industry and the largest contribution to American economic and military security.

We are pleased to note that S. 2662 would preserve the keystone of the ODS program even while it proposes radical alterations in its administration. That keystone is the concept of full parity with regard to the differential in the American standard of living versus that of the rest of the world. American industry generally has only begun to realize the full impact of this vast differential in the last decade; the ocean shipping industry has lived with it for many decades. In large part it was the foresight of the Congress in its creation of the principle of parity in the ODS program that has allowed the industry to survive.

Operators of many foreign registered vessels are able to engage in what other industries would label "dumping" practices for two principal reasons. First, ocean shipping is a nearly perfect substitutable service; moving cargo from point A to point B can generally be accomplished on any marginally seaworthy vessel. And second, these operators are able to exploit their shipboard labor with impunity, paying wages and benefits so far below American standards as to make comparisons meaningless.

American labor union members, corporate executives and government employees all share equally in the benefits of our unmatched standard of living. Congress rec-

ognized this in 1936, and chose a rational course to develop a merchant marine capable of competing in such an environment. Since then, many of our Western allies have narrowed the gap in wage and living standards as measured against the United States. This has been reflected in reduced ODS wage differential calculations in trades where fleets from those nations predominate. However, our allies' fleets are experiencing the same shocks and dislocations as the American fleet. Low cost third world fleets are a fact today; they will be here tomorrow; and they will continue to wreak havoc in the ocean shipping markets of the West for the foreseeable future. It is in that context that I see no choice but to continue that same rational course to provide for full parity in the proposed new subsidy program described in this bill. To provide for anything short of full parity would condemn our operating companies to permanent non-competitiveness. If we choose that course, then we have also chosen to cashier the American merchant marine.

The fundamental question before this Subcommittee, and the industry itself, is whether all parties who will be subject to the new regime crafted in this bill will be treated fairly and equitably. Clearly, the extraordinarily long gestation period in its drafting indicates there were many fairness tests that had to be met along the way. As a union president, I add to this test the likely impact of such legislation on the job prospects of my members.

I am deeply concerned that the draft bill you are considering today does not meet the fairness test. It appears that our large liner companies are reasonably satisfied with the outcome so far, but I am not convinced that that view is held by the small liner companies. I know that the large companies represent the majority of the ships in the fleet, and the jobs of my members. Yet I fear there may have been an attempt to ignore the special needs of our small companies, and I cannot endorse any such effort. These companies, while perhaps currently lacking the economic and financial clout of their larger competitors, have been in our business for the long term. They have made long term investments in vessels. They have all been more prosperous, when they too would have been labeled a "large liner company". Now is not the time to push them aside. Certainly if the larger companies, with all of their differences, could reach a compromise solution, then the same must be true with respect to the smaller companies.

If enacted, this bill would eliminate provisions of current law variously seen as either safeguards for the preservation of fair competition, or regulatory beartraps with no redeeming features. All of the companies have over time held one or both of these views toward sections 211, 601(a), 605(c), 606, etc. In moving from a system of mixed subsidized and unsubsidized liner companies to one where all of the companies would be subsidized, the need for these sections becomes less certain indeed. But clearly the debate is not over; if it were, we would see the small companies endorsing this bill. I urge caution and a judicial temperament, and I sense the Subcommittee's agreement.

The need for equity among competing liner companies carries through to the other subject addressed at the hearing, which is the Maritime Administration's proposal to realign the so-called "essential trade routes" into broadly defined "trade areas", and to amend or discard General Order 80, an administrative provision concerning the unsubsidized vessel operations of otherwise subsidized operators.

We examined these issues when they were first announced by MarAd in the Spring of 1985. The most significant aspect of their proposal was the total absence of a rigorous analytical basis for the proposal. It was a clear-cut example of having begun with a conclusion, and harmmering the "analysis" to fit the result. In comments submitted to the agency at that time, we vigorously opposed these actions, principally on the basis of fairness. MarAd's total failure to address the likely economic and financial consequences of these actions left us and many others no alternative.

While re-writing the rules on trade routes and unsubsidized vessel operations would grant significant relief to certain operators, it is equally clear that other companies could suffer irreparable economic harm.

Unquestionably, S. 2662 deals with these same issues. I am reasonably convinced that the various liner companies participating in this debate have balanced their own gains and losses from the total relaxation of trade route restrictions and prohibitions on unsubsidized operations in the context of the comprehensive re-writing of Title VI represented by this bill. It is only in the context of this total package that fair treatment of all parties can be assured.

We can support most of the "deregulatory" efforts in this bill, as long as there is consensus on the inter-company equity issue. We know what the foreign companies are able to do, and we want to be counted among those favoring the best possible operating environment for our companies. Their success translates into job security

for the licensed officers that we are privileged to represent; their failure is a burden we all share.

There is, however, one matter on which I cannot come to terms. It is the so-called "foreign-flag feeder" issue, but more precisely relates to section 804 in the 1936 Act. I am deeply chagrined that companies seeking and needing government assistance to sustain their operations are also seeking to expand their foreign-flag fleet holdings. It may be convenient, and it is no doubt cheaper. It may even be an undeniable trend in the world shipping business. My question for the Subcommittee is this: "Is this good policy for the development and maintenance of an *American* merchant marine?" NMEBA believes it is not. It is a policy for the diversion of financial resources, in part, built on government subsidies, for the benefit of foreign entities.

One of the foundation stones in this bill is its "wages only" subsidy. Part of the rationale for this effort is the maintenance of a skilled labor force ready to take on the task of mobilization for war or emergency. But where are the job expansion opportunities in S. 2662? I see perhaps some job maintenance, but I also see employment loss if foreign feeders are allowed to take over the role of cargo prime-movers. I cannot endorse the active promotion and development of a growing foreign-flag fleet with no prospect of my membership enjoying any benefits. The companies have put forward a sincere representation of their need for flexibility in servicing the large line-haul vessels that are becoming the standard of the industry. And they have scaled back their initial effort to have a totally free and unrestricted access to foreign ships while receiving subsidy. For our part, we too have recognized certain legitimate needs and have not tried to block unilaterally any discussion or recognition of this issue. But I am deeply concerned the current language in the bill may be grossly inadequate.

I would ask three things of the Subcommittee on this matter. First, the policy implications of relaxing current restraints on foreign-flag ship holdings, affiliations and operations should be fully aired so that we all understand that we are *not* building up American ships, American jobs or American security preparedness by such provisions. Second, we should not close the door on possibly making some level of subsidy available for foreign feeders, so that American labor can be utilized. And third, I would call your attention to specific provisions in S. 2662 in sections 620 and 625, and the conforming amendments of section 4 of the bill that deal with foreign-flag feeders. I must insist on an effective control valve to prevent a hemorrhage of cargo from our American liners to these foreign ships.

S. 2662 proposes an overly generous "two-for-one" formula at section 4 of the bill which would grant an operator up to two foreign feeders for each "contract vessel." Feeders are defined at section 625(11). Contract vessels are defined at section 625(2).

These three provisions must also be read in the context of section 620(b) which deals with foreign-flag vessel operations generally. My request is that you and your staff analyze the scope and effect of these elements. If through cleverness a subsidized operator artifically inflates the number of its "contract vessels" for the purpose of acquiring more and more foreign feeders, then we are all victims of subterfuge. We would like the record to be clear on this point: the *privilege* of operating foreign feeders must be *earned* by operating U.S.-flag liners on a full time basis; it ought not be accorded the status of a right or entitlement, subject to manipulation.

In part, current law recognizes these matters, and we would advise that section 804 could serve as an appropriate model. We believe we are on solid ground in making this request. The companies are seeking and we are not objecting to space charters and voyage charters on foreign vessels; "grandfathered" foreign vessel operations in the Atlantic and Caribbean; a two-year transition period for four foreign ships while they are reflagged in the U.S.; and the ability to perform agency and brokering operations for foreign ships. In this light, we do not believe we are asking for anything more than due consideration.

We have a number of other concerns as well. It is unclear to us precisely how the issue of constructing and acquiring foreign built vessels is resolved in this bill. NMEBA has consistently supported "build foreign" as a way to help our companies modernize their fleets at world prices. But we have never supported the acquisition of the world's scrap candidates as part of this arrangement. We cannot upgrade our fleet with everyone else's cast-offs. While unclear, it appears this bill may allow this to happen, and if so we cannot support it. No operator should be denied the ability to bring in its current fleet holdings or vessels on order. But those vessels should represent the only exception to a firm "no old hulls" rule.

We are also uncertain what impact (if any) this bill would have on domestic trade operators. Simply put, we do not want any adverse consequences to befall that trade as a result of this bill; again, the issue is fairness.

I have generally endorsed this bill, but I have urged caution and have outlined some key aspects of the bill that still trouble the NMEBA. We want to play a constructive role in shaping this landmark legislation if indeed the industry can agree to the radical changes being proposed. I want to leave the Subcommittee with no doubts on some key points. We support the more timely payment of subsidy proposed in this bill. We support the foreign acquisition of liner vessels, to the extent they are newly built tonnage. We support the elimination of the so-called three year rule for preference cargo eligibility if all companies can share in this benefit equally. Within the parameters explained above, we support a fair deregulation of the subsidy program. We support the concept of all companies being eligible for subsidy on their qualified liner vessels. We endorse the restriction of this bill to the liner trades only. But we would urge the Subcommittee to give the closest scrutiny to the likely impact on small companies, and the effects on unsubsidized domestic carriers. We cannot endorse the treatment of foreign-flag feeders provided in this bill. We stand ready to assist in any way possible.

AMERICAN INSTITUTE OF MERCHANT SHIPPING,
Washington, DC, August 4, 1986.

Hon. TED STEVENS,
Chairman, Subcommittee on Merchant Marine,
U.S. Senate, Washington, DC.

DEAR SENATOR STEVENS: The American Institute of Merchant Shipping (AIMS) is a national trade association representing 22 U.S.-flag shipping companies which own or operate approximately nine million deadweight tons of tankers, dry bulk carriers and other oceangoing vessels engaged in the domestic and international trades of the United States.

AIMS greatly appreciates the opportunity to comment on S. 2662, "The Liner Development Act of 1986".

While AIMS does not think it is appropriate to comment on the subject of operating differential reform for liner vessels, AIMS would like to express its concern with the amendments to Section 901(b)(1) of the Merchant Marine Act of 1936 (46 U.S.C. 1241(b)(1)). The amendment eliminates the three-year waiting period that now applies to vessels built or rebuilt outside the United States or documented under foreign registry prior to being documented under U.S. registry before they are fully eligible to engage in lifting government preference cargoes. AIMS is adamantly opposed to waiving the three-year waiting period for bulk cargoes. However, as it pertains to strictly liner cargoes, we would defer to the liner carriers' views on that subject.

Waiver of the three-year waiting period for bulk cargoes would go a long way toward destroying the existing unsubsidized portion of the U.S.-flag tanker and dry bulk fleet. It seems clear that unsubsidized vessels cannot possibly compete with vessels whose costs are far less whether because of subsidy or foreign construction and operation, or both.

Bulk government preference cargoes are important to the unsubsidized operators that consider their availability in making an economic evaluation of whether to build high cost U.S. built, U.S.-flag tonnage. Waiving the three-year waiting period would be tantamount to denying accessibility of bulk government preference cargoes to unsubsidized non-liner operators.

AIMS feels that a slight modification in the proposed language of S. 2662 to amend Section 901(b)(1) of the Merchant Marine Act of 1936 would alleviate our concerns if the pertinent language were changed to read, "or (3) a vessel is a qualified *liner* vessel operated by a contractor pursuant to Section 616 through 625 of this Act." (The italicized language is our addition.)

AIMS would ask that the modified language recommended above be inserted in S. 2662. In addition, when considering this ODS liner bill, you should analyze the impact this will have on the carriage of preference cargoes by non-subsidized bulk vessels. As you know, the liners carry substantial amounts of government-impelled preference cargoes in parcel lots. If S. 2662 is enacted, it could mean that the subsidy provided in this bill will result in a significant competitive advantage for the subsidized liner operators with respect to the carriage of preference cargoes.

Sincerely,

ERNEST J. CORRADO, *Vice President.*

○